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Uganda Economic Update

4th Edition, June 2014

Reducing Old Age and Economic Vulnerabilities:

Why Uganda should Improve its Pension System

THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

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ABBREVIATIONS AND ACRONYMS

BoU	Bank of Uganda
BOP	Balance of Payments
CBR	Central Bank Rate
DSA	Debt Sustainability Analysis
EAC	East African Community
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
ICT	Information and Communications Technology
IFC	International Finance Corporation
IFPRI	International Food Policy Research Institute
ILO	International Labour Organization
IMF	International Monetary Fund
IPPS	Integrated Pay and Pension System
LIBOR	London Interbank Offered Rate
MDRI	Multilateral Debt Relief Initiative
MFPED	Ministry of Finance, Planning and Economic Development
MoPS	Ministry of Public Service
NDP	National Development Plan
NEER	Nominal Effective Exchange Rate
NSSF	National Social Security Fund
NTBs	Non-Tariff Barriers
NTMs	Non-Tariff Measures
ODA	Official Development Assistance
PIMS	Public Investment Management System
PSPF	Public Service Pension Fund
PSPS	Public Service Pension Scheme
REER	Real Effective Exchange Rate
SMEs	Small and Medium-sized Enterprises
SSA	Sub-Saharan Africa
UEU	Uganda Economic update
UGX	Uganda Shillings
URA	Uganda Revenue Authority
URBRA	Uganda Retirement Benefits Regulatory Authority
VAT	Value Added Tax
WB	World Bank
WDI	World Development Indicators

FOREWORD

I am pleased to introduce the fourth edition of the Uganda Economic Update series. Following the structure of earlier editions, the Economic Update discusses recent macroeconomic developments, as well as a special topic - why Uganda should improve its pension system.

Over the past year, Uganda has managed to grow above five percent amidst droughts, disruptions related to civil unrest in South Sudan, and aid cuts. Furthermore, prices have stabilized and foreign direct investment has surged. The country's chronic deficiencies in physical infrastructure are also being addressed by an ambitious public investment program, which has the potential to lay the foundation for an acceleration of economic growth, toward seven percent or above annually, required for Uganda to reach middle-income status over the next decade. However, the Government will have to balance its ambitious investment program by raising more domestic revenues. On this front, Uganda's performance has continued to be poor, when compared to peers, and needs to be tackled by strong measures. In view of declining aid, commercial borrowing on both domestic and foreign markets has become a realistic option but should be carefully managed. Not only debt and fiscal sustainability are at stake but the Government will have to be cautious not to crowd out the domestic private investment, which has been growing slowly.

Over the past two decades, Uganda has made great strides in reducing poverty, which has more than halved from almost 60 percent in 1992 to below 20 percent in 2013. Acceleration in economic growth is expected to reinforce this trend in the future. However, growth alone may not be sufficient. As experienced in many countries, part of the population is likely to be left out from the benefits of growth benefits.

In that context, an effective social protection system is needed to protect vulnerable groups from negative economic shocks such as loss of employment, death of bread winner or bad weather. There are several groups of vulnerable people in Uganda, each with differentiated needs. One such group is the elderly, whose distinct needs may warrant a distinct policy response. While this group is still a small fraction of the population today, it is projected to increase fast, reaching approximately six million people by 2050. In this context, the fourth Economic Update asks whether the Uganda pension system could play a better role in protecting the elderly against poverty and vulnerability at the individual and household levels. Can the pension system contribute to achievement of broader economic goals? Are reforms needed to reduce fiscal liabilities related to paying pension benefits? These questions, and others (also related to the Uganda pension system), are examined in the second part of this Economic Update in light of the recent experience in Uganda as well as of international best practices.

As with previous editions, I hope that this fourth Uganda Economic Update will stimulate, and contribute to, the debate among stakeholders on this important agenda.

Philippe Dongier
Country Director | Tanzania, Uganda and Burundi

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The report benefitted from insights of peer reviewers including Mark Dorfman, Senior Economist; Gustavo Demarco, Lead Economist; and Sarah Coll-Black, Social Protection Specialist,

Close collaboration with external stakeholders was intended to ensure the relevance of the messages to policy makers and practitioners. These external collaborators included the Uganda Retirement Regulatory Authority, the Ministry of Gender and Social Development, and the Ministry of Finance, Planning and Economic Development. Consultants, Lillian Keene Mugerwa and Prof. Vincenso Galasso, analyzed the political economy of pension reform. Irfan Kortschak provided professional editing services.

KEY MESSAGE

Only 2% of elderly Ugandans are covered by any form of pension protection. The rest age at their own peril, surviving through family support or toiling away in subsistence activities, particularly in agriculture.

Margaret Nsubuga may have earned her pension as a public servant, but she has not been receiving any pension since January 2001, when her file disappeared(Great Lakes Film Production, 2014).

Around 275,000 Ugandans qualify for pensions following their retirement under the country's public pension scheme. Although the pensions paid through this system are not large, they go a long way towards meeting the basic needs of the recipients and their families. In addition, a number of other Ugandans may receive entitlements after making contributions to the National Social Security Fund or to voluntary schemes established by employers in the private sector. However, at present, only two percent of elderly Ugandans are covered by any form of pension protection. The rest age at their own peril, surviving through family support if their families are able and willing to provide it, or toiling away in subsistence activities, particularly in agriculture.

Ongoing pension reforms currently being implemented in the country may go a long way towards addressing poverty and vulnerability in old age for a larger proportion of the population. Less than five percent of Uganda's population is above the age of 60. However, many people in this age bracket are vulnerable to poverty, with 65 percent suffering from old-age related disabilities and with 11 percent of them living alone. The majority of Uganda's elderly population continues to fulfil household and family responsibilities. With Uganda's demographic changes, the elderly will constitute an increasingly large proportion of the population, placing greater pressure on the Government to provide social protection.

Improvements in the functioning of the pension sector can generate sizeable macroeconomic impact and a number of benefits for the broader population. First, if existing pension assets are efficiently managed, it will allow savers to receive a reasonable return on their savings. Second, a better managed pension system will reduce the fiscal pressure that may arise as the number of recipients of public pensions grows. Third, if appropriately managed, these assets may contribute to the development of long-term finance for investment and of financial markets.

As with previous editions of this update, the fourth Uganda Economic Update provides information related to the current state of the economy, before focusing on a particular subject of importance, in this case, on how pensions can reduce vulnerabilities at both individual and macroeconomic levels. Well designed and managed pension systems can contribute significantly to the country's ongoing transformation.

Part 1: State of the economy

The Ugandan economy has continued the process of recovery that began in FY 2012/13, growing by 5.9 percent during the first half of FY 2013/14. This rate is still lower than recent historical averages, which were in excess of seven percent. However, with eight consecutive quarters of positive growth since the slump in FY 2011/12, the economy has clearly returned to its previous strong growth path. Growth was supported by a sustained increase in public investment, from a value equivalent to 5.7 percent of GDP in FY 2011/12 to 6.1 percent of GDP in FY 2012/13, and eventually to a projected value equivalent to 6.8 percent in the current year. Consequently, the construction subsector recorded a good rate of growth due to increased public investment in infrastructure. As has been the case in the recent past, growth during the current year has been mostly driven by increased economic activity within the services sector, which employs an increasingly large proportion of the labor force. The manufacturing sector is also growing fast, benefitting from improved electricity supplies, lower interest rates, and increased domestic and regional demand. However, both private investment and consumption have been slow in recovering, partly because commercial banks took longer to adjust to the easier monetary conditions during FY 2012/13.

With low inflation and a stable local currency, Uganda's monetary policy stance remained mostly unchanged for the first half of FY 2013/14. As a result, commercial banks started to reduce their interest rates. The real cost of credit declined to an average of 14 percent by March 2014, compared to 20 percent of the previous year. This, together with the gradual increase in foreign interest rates, has resulted in an increase of more than seven percent in shilling-denominated credit to the private sector over the first eight months of FY 2013/14.

The current account significantly improved during FY 2012/13, reaching a value equivalent to 7.4 percent of GDP, almost three percentage points lower than in the previous year. Official aid inflows declined by 17 percent during FY 2012/13, following corruption scandals in that period. In contrast, foreign direct investment and remittances have remained strong, preventing the country's overall external position from deteriorating as official donor inflows decline. However, the external position is expected to deteriorate as the implementation of infrastructure projects accelerates, resulting in increases to the import bill. In addition, the crisis in South Sudan resulted in a decline in the volume of exports to the South Sudanese market in the first three months of 2014.

Pressure on the fiscal side is continuing due to the lower than expected levels of domestic revenue collection, with the Uganda Revenue Authority failing to collect 0.6 percentage point of GDP of taxes, especially corporate taxes and value added taxes. In addition, the continued decline in official aid inflows amidst planned high expenditures on infrastructure may be disruptive. The overall deficit could therefore exceed a figure equivalent to five percent of GDP, although several large infrastructure projects have not been implemented as planned. The Government has financed the higher deficit through domestic borrowing.

As a result of increased public investment, the Ugandan economy is likely to grow faster, at a rate of approximately 6.2 percent in FY2014/15, and to maintain this upward trajectory into the near future. The predominant source of growth will be an increase in the economic activity of the construction sector, as Uganda prepares for the production of oil and invests heavily in a number of major infrastructure projects. Unfortunately, the agricultural sector, which employs the bulk of the labor force, is unlikely to achieve high rates of growth because of persistent supply-side constraints, such as the limited use of improved inputs, the lack of irrigation systems and low levels of mechanization.

The economy could grow at an even more rapid rate if the completion of current public infrastructure projects result in higher levels of private investment and the business environment improves.

High levels of public investments in the medium term will also lead to widening fiscal deficits, which Government envisages to finance through higher commercial borrowing on the external market. This may also increase debt levels. Part of the increase in expenditure in FY 2013/14 involves one-off investments that are necessary to address Uganda's infrastructure gap. However, there are still inefficiencies in public investment management. Therefore, if these investments are not accompanied by measures to strengthen public investment capabilities, the increase in public expenditure could lead to the build-up of an unsustainable debt stock.

Higher fiscal deficits are expected to slow down private investments as a result of the increasing domestic borrowing by Government. During the first half of FY 2013/14 the real cost of credit declined. However, the excessive issuance of domestic government debt to fill the gap created by declines in aid inflows or to facilitate increased expenditure may be extremely costly to the economy, possibly resulting in the crowding out of private investment as it drives up interest rates.

KEY MESSAGE

To ensure that Uganda continues to achieve a high rate of growth, the Government will have to manage a number of risks, particularly those resulting from weaknesses in the fiscal management regime. The reduction of aid inflows to Uganda could have implications for the Government's commitment to accelerating expenditure on infrastructure and for the macro-stability of the economy. If aid flows to the Government are redirected to non-government organizations so that overall aid inflows to the country are maintained at current values equivalent to approximately 1.4 percent of GDP, the impact on the macroeconomic outlook would not be as severe as had been feared. However, disruptions may be experienced by some sectors, particularly health and infrastructure. Therefore, the Government will have to resist additional spending pressures and increase efforts to collect tax revenues. With the upcoming 2016 elections, particular care will be required to contain spending pressures to prevent non-priority expenditure in the pre-election period, causing excessive inflation.

The biggest external risk relates to the South Sudan crisis. Given Uganda's increased dependence on South Sudan markets for its exports, the protracted crisis in South Sudan could have severe consequences for trade, remittances and overall economic activity.

With eight million Ugandans still living below the poverty line in 2013, it is clear that the mere achievement of a high rate of economic growth is not enough to ensure inclusive development. With the rapidly expanding population, the proportion of the population living below the poverty line is still large, with many households remaining vulnerable to shocks and to the risk of falling into poverty.

Looking forward, social policies have to complement growth policies and hence should be pursued concurrently to eliminate extreme poverty. In the short run, this will face challenges, especially if spending on social policies is considered to be taking away resources from those areas, such as infrastructure, that would generate growth faster.

Part 2: Pensions: Achieving the vision of a transformed Uganda means addressing vulnerabilities at both individual and at country levels

A coherent policy of social protection for vulnerable groups, including the elderly, can promote positive social transformation and accelerate economic development. The establishment of a comprehensive national social protection system that meets the needs of all Ugandans, including the poor and vulnerable, will require a significant allocation of resources, a high level of commitment, and considerable thought. Hence, a step-by-step approach is required. Pensions are only one element of this strategy, but reforming the pension system can bring additional benefits in terms of financial deepening, fiscal sustainability and equity, and economic growth.

A well-functioning pension system can reduce the risk of a significant proportion of the population falling into poverty in their old age. Pensions also bring benefits for those that are not direct recipients, as incomes are often shared with household members. For instance, elderly household members often provide food, clothing and school materials for grandchildren or other dependents. At the macro level, appropriate management of pension assets also (i) ensures that savers get a reasonable return on their savings, (ii) reduces the fiscal burden of providing pensions as the number of recipients of public pensions grows, and (iii) contributes to the development of long-term finance for investment and of financial markets.

Uganda's pension system is about 80 years old, serving all public servants through the Public Service Pension Scheme (PSPS), and some private pensioners who contribute to the National Social Security Fund (NSSF) or to other voluntary schemes. However, pension coverage is too limited to achieve the primary objective of providing social protection, and the system still fails to generate many of the potential benefits that could accrue from a well-functioning pension system. The current social pension scheme covers only about 10 percent of the working age population, most of whom are urban workers. It does not extend to the majority of citizens, including those employed in the agricultural sector, the self-employed, and those employed in the informal sector.

The bulk of Uganda's expenditure on pensions involves the payment of pensions under the PSPS. This scheme is extremely expensive and unsustainable, involving entitlements that are on average equivalent to three times the per capita wage. Despite the low overall coverage of the scheme, with less than two percent of the population receiving retirement benefits, Government spending on this sector reaches a value equivalent to 0.4 percent of GDP. In the long run, this is forecast to more than triple.

In the private pensions, the bulk of the existing pension assets are held by the NSSF, which for a long time suffered from weakness in administration, resulting in the loss of pensioners' money through direct fraud, mis-investment, and high cost of administration. Estimates suggest that for every one percent annual loss charged on the assets over a pensioner's full career span, the ultimate value of an individual's pension is reduced by 20 percent. Using this assessment, the NSSF pensioner ultimate incomes have been reduced significantly over the past years.

Apart from providing a social safety net for the elderly, a well-managed pension system may contribute to economic growth and to increased savings. Under the right conditions, properly managed pension systems can play an important role in the development of financial and capital markets, which in turn contributes to economic development and growth.

A well-managed pension system can also facilitate an increase in financial savings, as a well-designed pension system requires workers to put aside current income for future use.
There is an urgent need for Uganda to concretize steps toward the development of a comprehensive social protection system, as detailed in the draft National Social Protection Policy. Failing to establish such a system will mean that a significant proportion of the population faces the risk of poverty in their old age, endangering the social pact in the country. The establishment of a coherent pension system that provides effective protection against poverty in old age for Uganda's citizens is one of the components of this system.

Since Uganda currently has a young workforce with a relatively small proportion of citizens of a pensionable age, it should seize the opportunity to build up its pension funds now, before its elderly population swells. The United Nations Department of Economic and Social Affairs projects that by 2050, 80 percent of people aged over 60 years will live in developing countries, with the number of Ugandans in this age bracket numbering six million. This implies that the rate of growth of this group in Uganda will be a full percentage point higher than that of the population at large. With the average long-term rate of population growth estimated at 2.6 percent, the number of old people in Uganda will be four times greater by 2050 than at present.

Uganda is already taking steps to establish an effective pension system. With the objective of improving coverage, adequacy, security, sustainability and efficiency in the management of pension assets in the country, Uganda has begun to implement a series of reforms to the pension sector. It has established a regulator to oversee the operations of the sector, it has proposed the liberalization of the private pension system to allow more competition and choice by workers, and it has proposed reforms to the public pension system to improve its efficiency and to ensure its sustainability.

Experience from other countries, including those in the African region, has shown that, although never easy and often controversial, successful reforms can be implemented to build efficient pension systems. However, even where reforms have been implemented, significant challenges remain, especially with respect to improve the governance of the new schemes to prevent fraud and corruption; to address the capacity gaps within government, new institutions and markets; and to manage the fiscal costs of transition into contributory schemes.

PART 1

STATE OF THE ECONOMY

Farmer in Mukono: Livestock farming is one of the pathways to accelerate agricultural commercialization(Great Lakes Film Production, 2012)

PART 1: STATE OF THE ECONOMY

- The Ugandan economy grew by 5.9 percent during the first half of FY 2013/14, driven mostly by the services and industry sectors. Eight consecutive quarters of positive growth since the slump in FY 2011/12, confirm that the economy has returned on the strong growth path and may reach a rate of growth of 6.0 percent per annum in FY 2013/14.
- With low inflation and a stable shilling, the monetary policy stance remained mostly neutral allowing the shilling denominated credit to private sector to start picking up.
- In spite of the decline in aid flows, Uganda's external position remained robust during FY 2012/13 due to strong foreign direct investment (FDI) inflows, but the position may deteriorate as import-heavy infrastructure projects start and the crisis in South Sudan lowered exports.
- The overall fiscal deficit reaching a value equivalent to about 5 percent of GDP during FY 2013/14 will be lower than had been programmed, but it is still high and mainly driven by revenue shortfalls and overruns in recurrent expenditure, while problems in the execution of large infrastructure projects continue.
- The economic outlook is positive with growth projected at approximately 6.2 percent in FY 2014/15; and is expected to keep the upward trajectory into the near future. The predominant source of growth will be an increase in economic activity of the construction sector, as Uganda prepares for the production of oil and invests heavily in a number of major infrastructure projects.
- The positive outlook is subject to risks, key among which will be those emanating from its fiscal management regime due to continuous low revenue collection and reduction of aid to Uganda; increased spending pressures in the advent of the 2016 elections, and accelerating public investments amidst gaps in public investment efficiency. In addition, given its recently increased dependency on the South Sudan market for its exports, the protracted crisis in South Sudan could have severe consequences to the Ugandan economy.

Straight from the garden, this farmer sells freshly harvested tomatoes in Masaka town (Sheila Gashishiri, 2013).

Compared to the high growth rates achieved following the restoration of peace and the adoption of wide-ranging economic reforms in the 1990s, the rate of growth of the Ugandan economy has slowed down in recent years. Over the past five years, the economy grew at an average of 5.8 percent, compared to an average of seven percent over the past two decades. This slowdown has occurred as a result of several shocks, including the global financial and economic crisis, recurrent droughts, and high commodity prices. In addition, it has also been the consequence of a waning growth dividend resulting from the recovery and economic reforms in the 1990s, while the constraints to growth, such as poor infrastructure, have become increasingly binding.

Notwithstanding this decline in Uganda's growth rates, the country has achieved significant results in terms of poverty reduction, with the rate of poverty declining by more than 50 percent over the past two decades. According to the National Household Survey, the proportion of Ugandans living in poverty steadily declined from 56.4 percent in FY 1992/93 to 19.5 percent in FY 2012/13. On the basis of these figures, Uganda has already achieved the first Millennium Development Goal (MDG) to halve the proportion of people living in poverty by the year 2015. The reductions in poverty have been achieved in both rural and urban areas, although a significantly greater proportion of people in rural areas continue to live in poverty, with the rate declining from 60.2 percent to 25.4 percent in rural areas and from 28.8 percent to 10.5 percent in urban areas over this period.

Despite this significant decrease in the incidence of poverty, a large proportion of the population remains vulnerable. Approximately eight million people continue to live in absolute poverty, while an estimated 43 percent of the population remains highly vulnerable to falling back into poverty due to the negative effects of changes in employment status, of natural disasters, and of other shocks, either at the personal, household, or community level.

Looking forward, the Ugandan policy makers will have to balance the pursuit of policies that promote rapid growth with those intended to reduce poverty. Firstly, in order to promote economic growth, the Government has often prioritized the development of costly infrastructure projects, thus leaving little fiscal space for social programs. Secondly, Uganda's population is growing at a faster rate than the rate of growth of productive employment, leaving a significant proportion of the population underemployed and vulnerable to poverty. Thirdly, significant oil reserves have been discovered in Uganda and the country is making a transition towards becoming an oil producer. While this will almost certainly result in an accelerated rate of economic growth, it will only facilitate a reduction in poverty if the appropriate pro-poor public policies are put in place. Without such policies, it is by no means certain that wealth will trickle down to benefit those currently employed in low growth, unproductive sectors, or those not employed. The challenge will therefore entail identifying the right mix of policies that will allow the country to achieve faster growth and economic transformation, while also gradually reducing the number of people threatened by poverty.

1.1. Recent economic developments

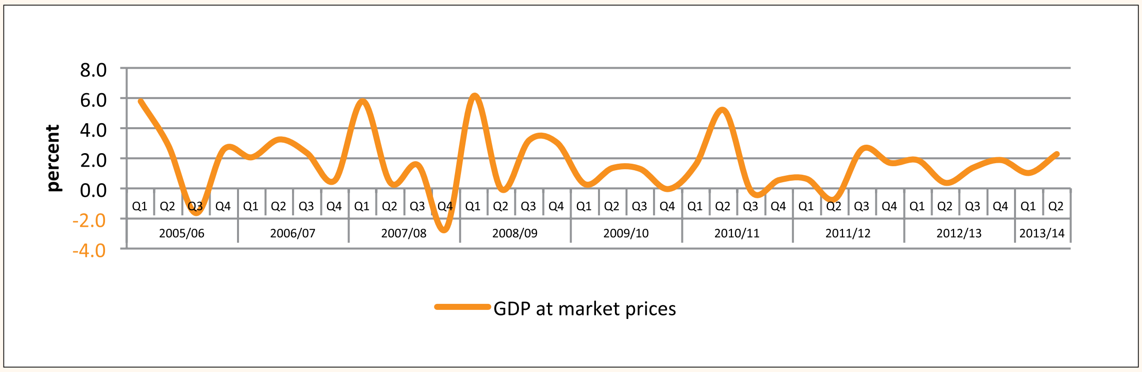
In the recent past, the Ugandan economy has faced several shocks, including the recurrent droughts, the disruptions related to the civil unrest in South Sudan and aid cuts. However, the economy began to recover in FY 2012/13 and continues to perform strongly in FY 2013/14. Uganda's external position has remained strong on account of continued FDI inflows, strong remittances and an improved trade balance. However, the fiscal deficit will be one of the highest over the last decade due to lower revenues, and higher than expected recurrent expenditures. The Government's infrastructure program has been delayed, which has reduced public investments.

1.1.1. Uganda's economy continues to grow

After a series of economic setbacks that began in 2012, the Ugandan economy began to recover in FY 2012/13, with this recovery continuing into the first half of FY 2013/14. Growth in GDP continued to gain momentum, increasing from a recent historic low of 3.4 percent in FY 2011/12 to 5.8 percent in FY 2012/13. This was considerably higher than the rate of 5.0 percent that the authorities had forecast for this period. In the first half of the current fiscal year, the economy grew by 5.9 percent[1] . Since 2012, the rate of growth of GDP has been positive in all eight quarters for which data is available. This is the longest period of continued economic expansion since 2007. In addition, quarterly real GDP growth has been much less volatile than in the period prior to this because of the more stable macroeconomic environment. Since the beginning of FY 2012/13, the rate of growth of real quarterly GDP has ranged between 0.4 percent and 2.6 percent per quarter (see Figure 1).

[1] Growth rate is calculated on year-on-year basis.

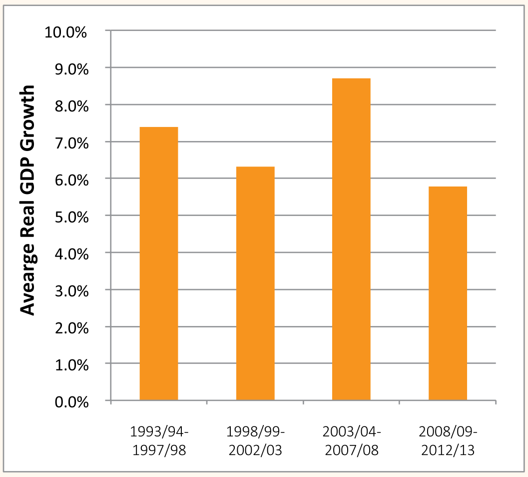
Figure 1: Quarterly real GDP growth at market prices stabilizing

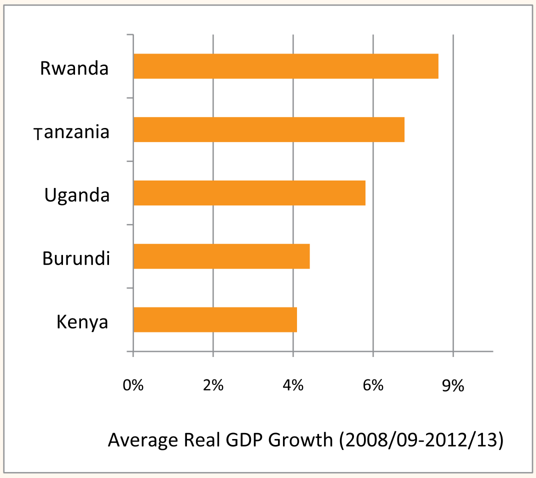


Source: Uganda Bureau of Statistics

The current growth rate is still below the long run average of 7 percent achieved over the last two decades and is also lower than levels recently achieved by some regional peers. Average annual real growth over the last five years fell to 5.8 percent, compared to 8.7 percent during the previous five years (see Figure 2). A range of external shocks, such as the global economic and financial crisis, high commodity prices and the recurrent drought conditions across the country, contributed to this slowdown. In addition, constraints such as inadequate infrastructure and inefficient financial intermediation are increasingly slowing down economic activity. Uganda's growth has also remained below some of its peers in the region over the past five years.

Figure 2: Declining GDP growth places Uganda below some of its peers in the region





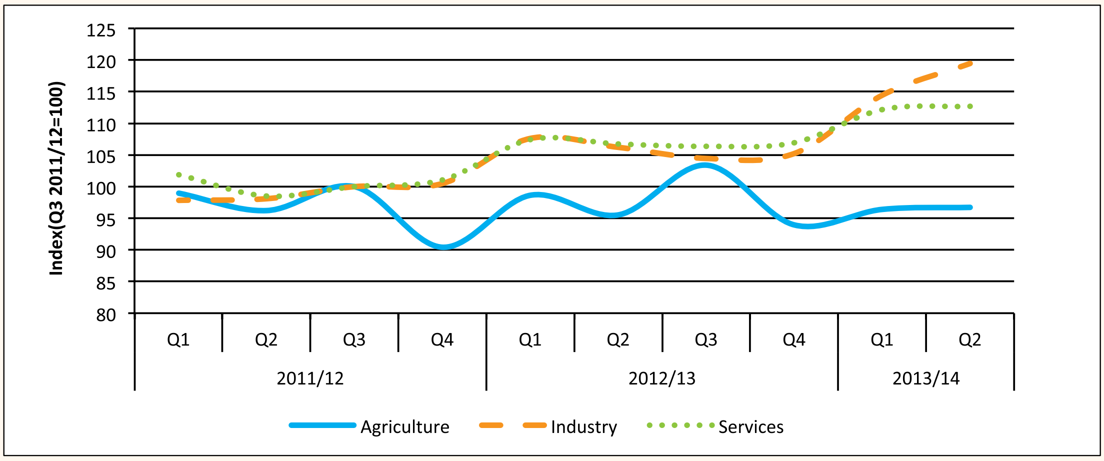
Source: World Bank, International Monetary Fund, and Uganda Bureau of Statistics

The recovery in the economy was the result of corrective measures to fiscal and monetary policies. After the Government adjusted its budget policies to stimulate growth, public spending, particularly capital expenditures, has been increasing since FY 2011/12. As a result, public investment increased from a value equivalent to 5.7 percent of GDP in FY 2011/12 to 6.1 percent of GDP in FY 2012/13, and is projected to reach 6.8 percent in the current year. Yet, both private investment and consumption have been slower in recovering, partly because commercial banks took longer to adjust to the easier monetary conditions during FY 2012/13. It is only recently that commercial bank credit to the private sector has started to accelerate slightly.

The main driver of economic growth has continued to be the services sector. This sector, which contributes more than 50 percent of the total value added to the economy, has achieved an average rate of growth of 1.7 percent per quarter since the start of 2012. This is higher than the overall average quarterly GDP growth of 1.6 percent over the same period. Within this sector, growth was driven mainly by the telecommunications, wholesale and retail trade sub-sectors and, to a lesser extent, by public administration. The services sector also absorbed the largest proportion of labor outside the agricultural sector. By the end of FY 2012/13, 82 percent of Ugandan workers outside the agricultural sector were self-employed, mainly in the services sector, compared to 40 percent in FY 1992/93.

The industrial sector[2] has also recorded significant growth, with an average rate of growth of 2.6 percent per quarter since the start of 2012. This growth was mainly driven by the manufacturing and construction sub-sectors. Operators within the manufacturing sub-sector, including those involved in food processing and the production of industrial materials, have particularly benefitted from better electricity supply, lower interest rates, and high domestic and regional demand, while the growth in the construction sub-sector has mainly been driven by increased public investment in infrastructure. More recently, there has also been strong growth in mining and quarrying activities[3], which more than doubled their output in 2013.

Figure 3: Services and industry maintain strong growth as agriculture stagnates



Source: Uganda Bureau of Statistics

Although the agricultural sector employs a larger proportion of workers than any other sector, its rate of growth is significantly lower than for the overall economy. The average rate of growth of value added in the agricultural sector has been only 0.2 percent each quarter since the start of 2012 (see Figure 2). As most Ugandan farmers continue to rely on traditional farming techniques and use few improved inputs, commercial activity is only slowly beginning to pick up. An increasingly unpredictable climate; a higher frequency of droughts; limited investment in irrigation; soil depletion resulting from limited fertilizer usage; and rising population pressures are creating additional challenges for the sector.

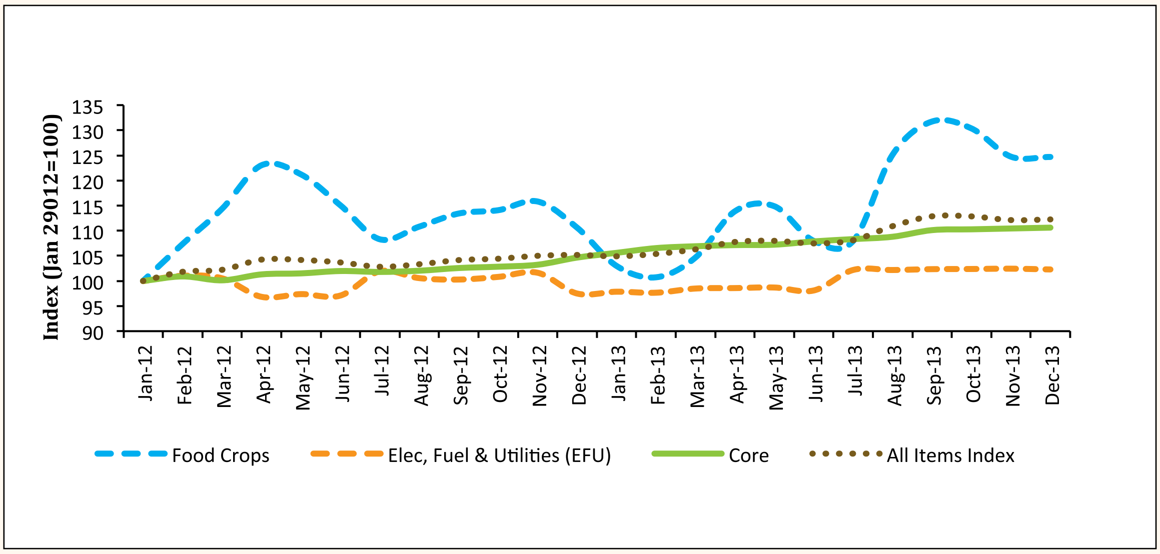
1.1.2. Inflation stable amidst shocks

After runaway inflation in 2011, the rate has declined to moderate levels over the past two years, but remains volatile. While the rate of inflation increased slightly during the first quarter of FY 2013/14, it later declined to 7.1 percent by March 2014. On the one hand, the return to a lower inflation rate was driven by the strength of the shilling, which appreciated in value over the year, shielding the domestic economy from a pass-through of foreign price volatility. On the other hand, a reduction in the international price of oil and improved energy supplies contributed to price moderation. In fact, the tariff reduction announced by Uganda's Electricity Regulatory Authority[4] is estimated to have

[2]According to the National Accounts, 'Industry' covers mining and quarrying, electricity supply, water supply and construction. Construction takes the largest share, 50 percent, while the share of manufacturing is 32 percent.
[3] Mining and quarrying does not include oil activities. These are currently captured under construction.
[4] In January 2014, the Electricity Regulatory Authority reduced electricity tariffs for the first time in nine years.

reduced the electricity bills by around 1-3 percent during the first quarter of 2014, depending on clients' consumption levels. However, the volatility in food crop prices[5] continued to cause sharp movements in inflation. Food crop prices increased by 28.3 percent per annum at the end of March 2014, a sharp contrast to the decline of 8.5 percent per annum at the same point in the previous year (see Figure 4). While a certain degree of volatility in the price of food would appear to be normal, given Uganda's bi-annual crop season, the magnitude of these swings reflects Uganda's ongoing exposure to weather hazards, particularly prolonged droughts, the effect of which is exacerbated by the limited use of irrigation systems in the agricultural sector

Figure 4: Volatile food inflation did not feed into core inflation



Source: Uganda Bureau of Statistics

1.1.3. Lending to private sector in weak recovery

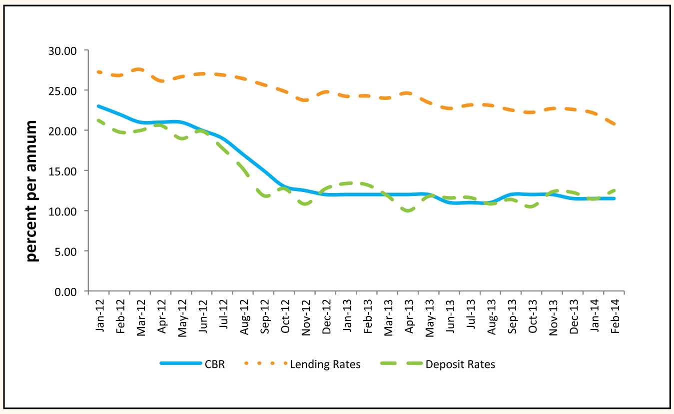
Monetary policy has been cautiously applied to prevent spillover inflation resulting from spikes in food prices. Through its inflation targeting framework[6], the Bank of Uganda has managed to control the rate of inflation, with decisive adjustments in its policy rate, the Central Bank Rate (CBR). The Bank of Uganda raised the CBR by half a percentage point to 12 percent in September 2013 to curb second-round effects from food supply shocks. However, this policy rate was later reduced to 11.5 percent in December 2013 as these fears subsided. The CBR has been maintained at this level since.

While commercial banks are quick to adjust their deposit rates in response to monetary policy, they are slow to revise lending rates and maintain high interest margins. Lower policy rates reduced interest rates on deposits, thus enticing savers to seek alternative investments. However, commercial lending rates had declined to a far lesser extent and with significant time lags (see Figure 5), although by December 2013, the Bank of Uganda's CBR was 11.5 percent points below its peak level in January 2012. This asymmetrical behavior is reflected in the persistently high interest margins as has been discussed in previous editions of this Update (Uganda Economic Update, Edition 1, February 2013).

[5] The food crops component carries a weight of 13.5 in the consumer price index.

[6] The BoU changed its monetary policy framework in 2011 introducing a new arrangement for controlling inflation which was termed the "Inflation Targeting Lite Framework". Rather than relying solely on open market operations and foreign exchange transactions to control liquidity in the monetary system, this new framework intends to emulate more advanced regimes targeting interest rates to control inflation.

Figure 5: Lending rates not declining as fast as other interest rates

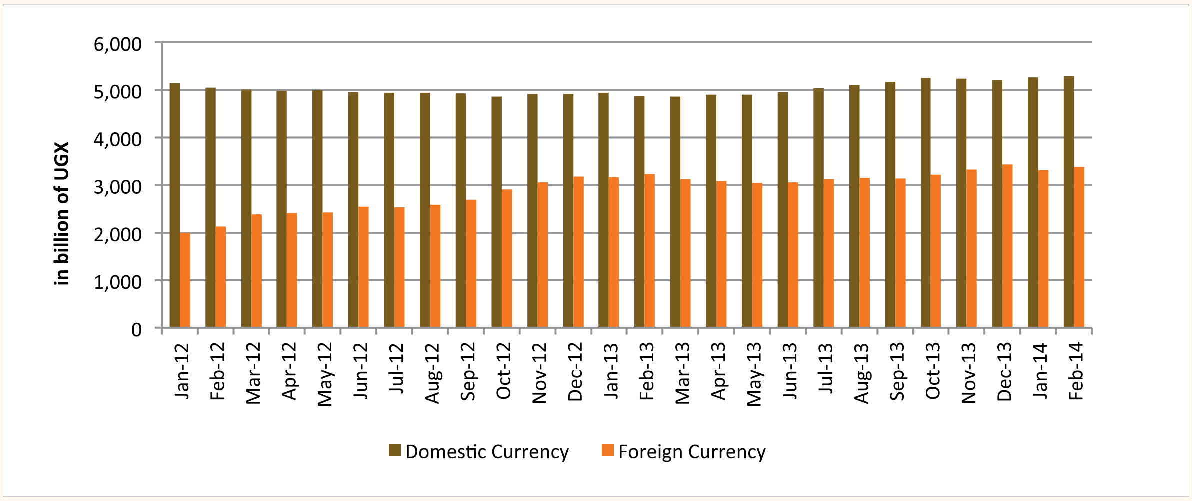


Source: Bank of Uganda

Industries , including these in the Namanve Industrial Park, Kampala, struggling to grow because of the high cost of credit (Sheila Gashishiri, 2013).

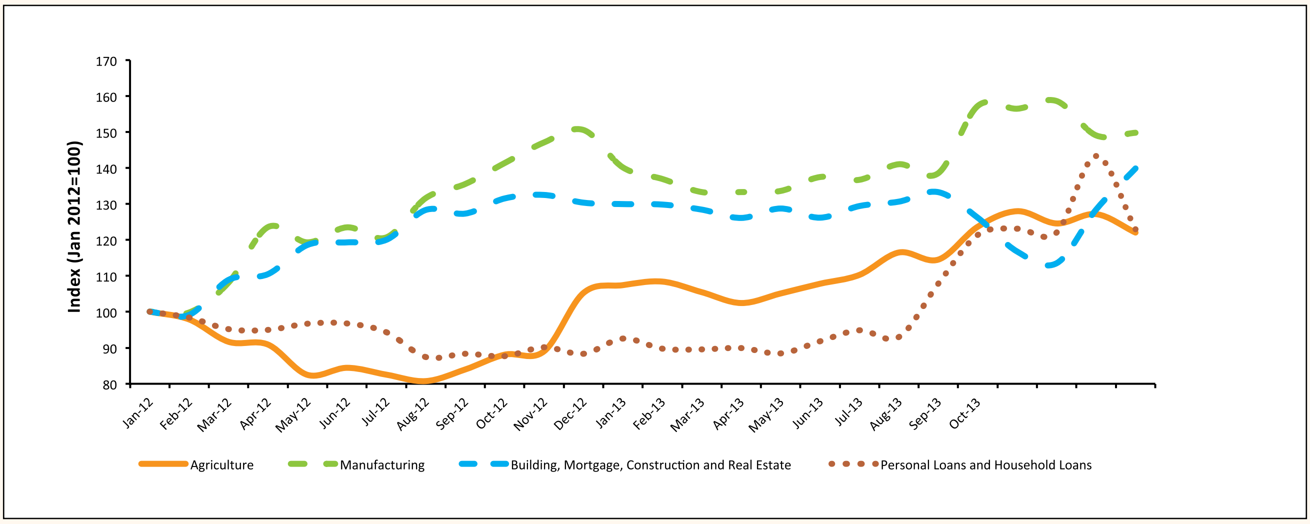
Despite these problems in the transmission of monetary policy, lending rates are declining faster in the first eight months of FY 2013/14, contributing to slightly higher private sector credit growth. In March 2014, real lending rates stood at an average of 14 percent, compared to 20 percent a year ago. This could have been one of the reasons why shilling-denominated credit to the private sector grew by seven percent over the first eight months of FY 2013/14 (see Figure 6). This is a welcome development, given that in recent years private sector credit growth had almost exclusively come from loans denominated in foreign currency. These types of loans carried nominally lower interest rates, but also bear an additional exchange rate risk. Since the beginning of FY 2013/14, credit to the manufacturing sector has grown by 13 percent; to construction by 11 percent; and to the agricultural sector by nine percent (see Figure 7). Lower interest rates have also supported an increase in consumption, with the aggregate total value of personal and household loans growing by more than 33 percent since June 2013.

Figure 6: Outstanding credit to the private sector



Source: Bank of Uganda

Figure 7: Private sector credit growth across sectors



Source: Bank of Uganda

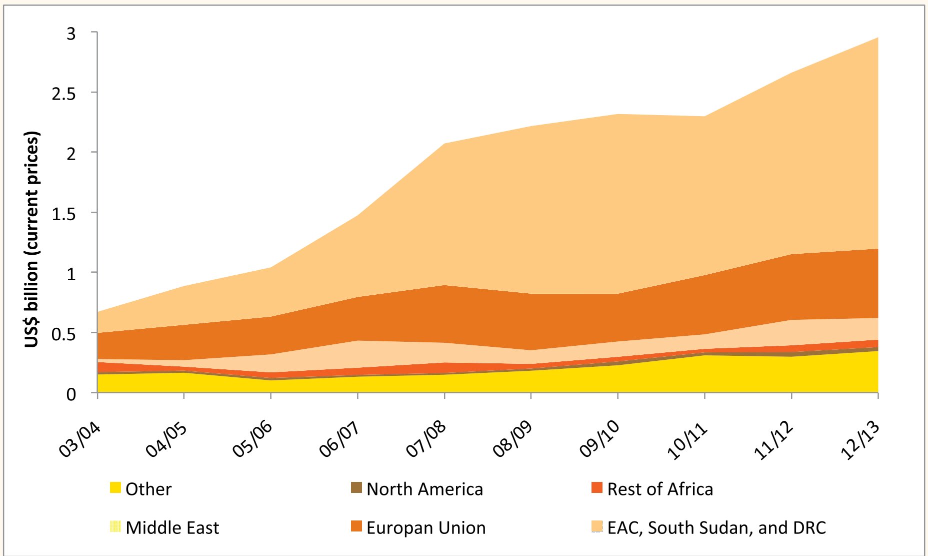
1.1.4. External position was robust in spite of lower aid inflows

Uganda's external position continued to improve during FY 2012/13, largely due to a decline in the value of imports into the country. The current deficit value equivalent to 7.4 percent of GDP in FY 2012/13, was significantly lower than in the previous year with 10.5 percent. The lower current deficit was largely due to a decline in the value of imports due to delays to the implementation of a number of major infrastructure projects and to uncertainties surrounding the Kenyan general elections during the third quarter of FY 2012/13. Indeed, merchandise imports, which shrunk by 3.8 percent, accounted for the bulk of the decline. Consquently, the total value of imports of goods declined to a level equivalent to 23.9 percent of GDP, from 27 percent in FY 2011/12. At the same time, the value of exports increased, following a period of low global demand, with a total growth in value of 12.2 percent in FY 2012/13. The increase was primarily driven by a growth in the value of non-traditional exports, such as metal and plastic products, bottled water, and rice, with an increasing proportion of these exports going to regional markets. At the same time, Uganda's traditional commodities, including coffee and tea, are still the most significant contributors to exports, accounting for 30 percent of the total value of export earnings during the last fiscal year (see Figure 8).

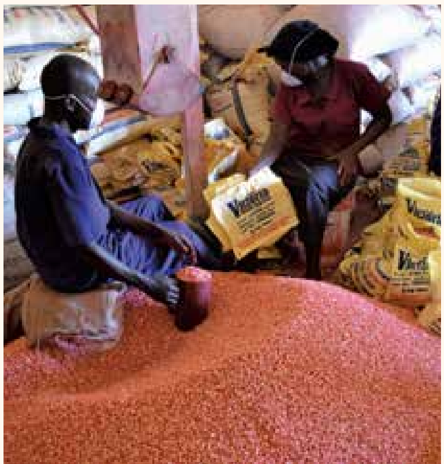
Strong inflows from tourism, worker's remittances and foreign direct investment (FDI) more than compensated for the rapid decline in portfolio flows. In spite of the good performance of the tourism sector, which generated US$ 1.1 billion in foreign exhange earnings during the year, the overall services and income accounts worsened, mainly due to increased expenditure on imported business services. At the same time, current transfers increased, driven by increases in the value of workers' remittances by more than 30 percent, to a total value of US$ 1.1 billion, while the value of official grants disbursements declined by 17 percent. The financial and capital account fell by 11 percent as the value of investments in short term instruments (normally referred to as portfolio investments) declined by 90 percent. This decline was largely due to the fall in domestic interest rates and market unease resulting from aid cuts. At US$ 1,245 billion, the value of FDI remained almost at the same level as last year. With the large improvement in the current account, Bank of Uganda increased foreign reserves during the year, with the import cover rising to a value sufficient for 4.6 months of imports of goods and services, compared to 4.3 months at the same point in the previous year.

The country's external position has weakened in first half of FY 2013/14. This resulted from an increase in Government imports and declining remittances. In particular, the total value of Government imports to support development projects have more than doubled during the current year, with a large proportion of expenditure on these imports being for machinery and equipment. The value of these imports account for approximately one quarter of the total value of all goods imported into the country. Nonetheless, the overall import bill has remained lower than last year's, mainly on account of lower prices on global markets. The total value of imports during the first eight months of FY 2013/14 reached the equivalent of US$ 3,325 million, 1.3 percent lower than the value during the correpsonding period in FY 2012/13. Due to the impact of the South Sudan crisis, exports to the markets in that country during the first nine months of FY 2013/14, were 19 percent lower than the level recorded in the correpsonding perido of FY 2012/13. The re-emergence of violence in that country since March 2014 is bound to further adversely affected trade for the reminder of the year. In contrast exports to Europe have started to increase as the continent begins to recover from several years of recession and as international prices begin to rise. The value of remittances inflows stood at US$ 478 million during the first half of FY 2013/14, 15 percent lower than the value realized in the first half of FY 2012/13. FDI inflows reached US $ 562 million, a value which was 44 percent over that realized during the first half of FY 2012/13. Meanwhile, portfolio investment inflows have been more volatile due to their short-term nature, often responding to movements in money market interest rates (see Figure 9).

Figure 8: Changing destination of exports helped Uganda's external position

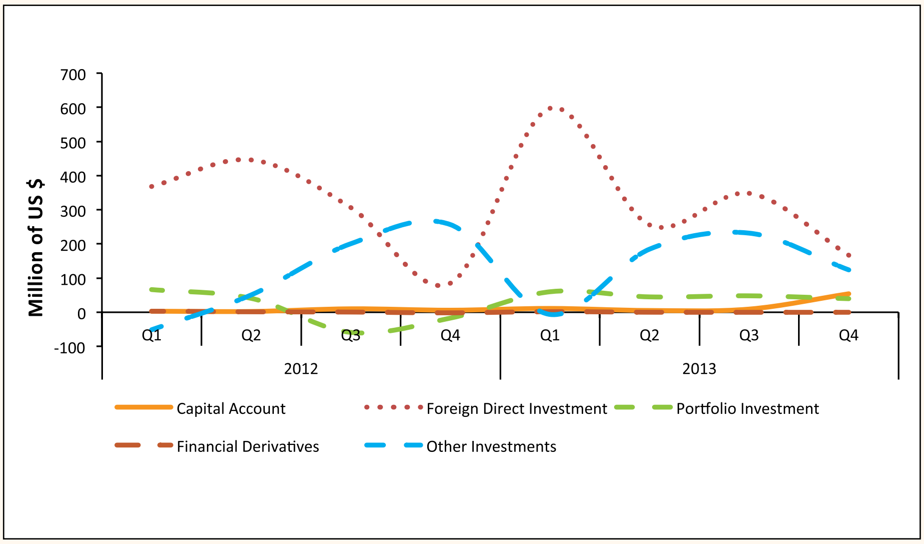


Source: Bank of Uganda



Victoria seeds Ltd, in Masindi, processing grains, one of the main commodities trade in the region(Sheila Gashishiri, 2013)

Figure 9: Capital and Financial Account more stable than usual

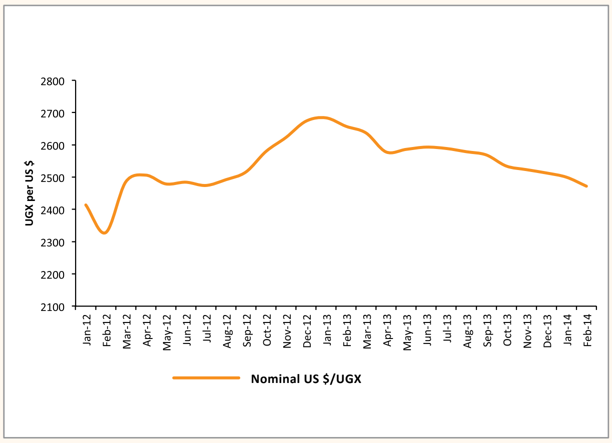


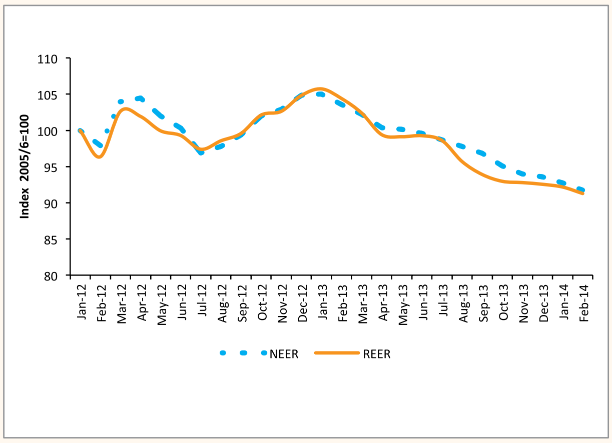
Source: Bank of Uganda

The value of remittances inflows stood at US$ 478 million during the first half of FY 2013/14, 15 percent lower than the value realized in the first half of FY 2012/13.

Trends in the balance of payments flows have resulted in increases to the value of the shilling. The value of the shilling has appreciated since the beginning of the year, possibly as an adjustment to recoup some of the value lost when the news of reduced aid sparked depreciation. With a lower rate of inflation in Uganda corresponding with the unchanged rates of its major trading partners, the real effective exchange rate appreciated even more steeply, by 8.0 percent over the first eight months of FY 2013/14 (see Figure 10).

Figure 10: Shilling appreciated further in spite of shortlived volatility in forex flows





Source: Bank of Uganda

1.1.5. Fiscal policy under pressure

In FY 2013/14, Ugandan policy makers continued to use fiscal policy as the main instrument for addressing key constraints to economic growth. To stimulate growth, the Parliament approved an expansionary budget for FY 2013/14, which projected an increase in total spending of 25 percent in nominal terms. As a share of GDP, total spending was budgeted to increase from a value equivalent to 18.9 percent of GDP in FY 2012/13 to 20.5 percent in this FY 2013/14. Domestic revenues were projected to increase from a value equivalent to 13.2 percent of GDP to 13.8 percent, partly compensating for the decline in external grants from 1.7 percent to 1.4 percent. Therefore, in the approved budget, the overall fiscal deficit was projected to increase from 4.1 percent of GDP in FY 2012/13 to 5.3 percent.

The significant rise in fiscal deficit was mainly explained by the Government's strong committment to increased capital investments to address existing infrastructure constraints to private investments and growth. In order to sustain the high growth rates realized in the past, Uganda has to overcome its infrastructure constraints, which requires considerably higher spending levels than in the past. Therefore, since the inception of the National Development Plan (NDP) in FY 2010/11, the Government has substantially increased its budget allocation for the development budget, which has increased by 126 percent in nominal terms over the last four years. The external contribution[7] to the development budget has remained constant at a figure equivalent to around 4.0 percent of GDP. Hence, the largest contribution to the growth of the development budget has come from domestic development, which now accounts for 39 percent of total expenditure in the FY 2013/14, compared to 27 percent in FY 2011/12.

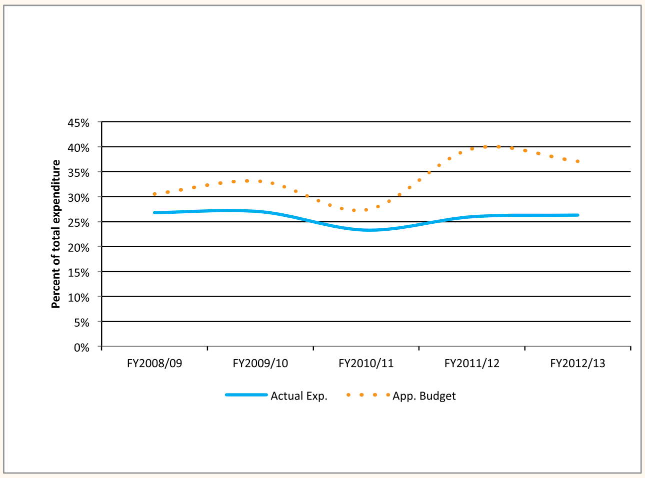
Due to implementation problems, however, increasing allocations for development have not resulted in higher realized levels of development spending. This has contributed to the huge backlog of infrastructure investments. Actual development spending has remained well below the levels envisaged in the NDP. Meanwhile, domestically financed development budgets have been under-executed by almost 40 percent in both FY 2011/12 and FY 2012/13. In fact, there has been no change in the composition of spending over the past five years. As a result, the backlog of planned infrastructure investments has increased by over US$ 1 billion, adding to planned infrastructure investments over the next five to seven years

[7] Including only donor projects financed through grants or concessional loans.

estimated at about US$ 9 billion[8]. These planned projects include a standard-gauge railway line, three large dams for hydropower generation, an oil refinery, and two highways connecting the capital Kampala with Jinja, which is the main east gateway for the country, and to Entebbe, the main air gateway.

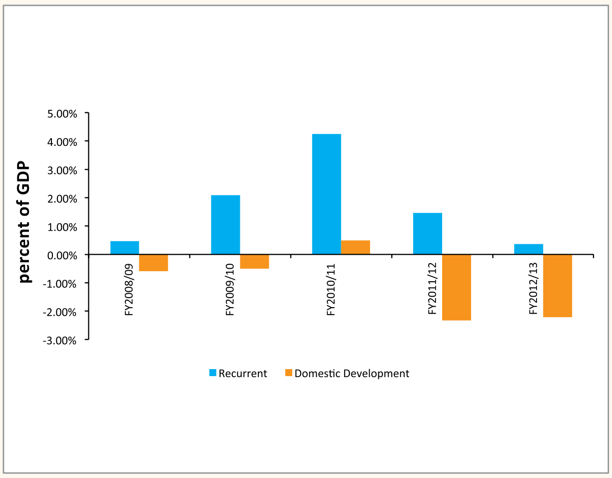
Both lower than expected domestic revenues and declining aid inflows have complicated the implementation of the FY 2013/14 budget. As in the past three years, the Government has had to accommodate the rising investment allocations amidst stagnant tax revenue and declining aid levels. The Government's original financing plans, which were based on additional resources from domestic revenues, have not materialized. In the first seven months of FY 2013/14, the Uganda Revenue Authority recorded a shortfall in the value of collected tax revenues of UGX 290 billion. The Government projects the shortfall to reach UGX 302 billion by the end of the fiscal year. The bulk of the shortfall is due to a lower than expected performance of 24 percent in corporate taxes and 11 percent in value added taxes, compared to the targets. Overall domestic revenue mobilization is projected to reach a value equivalent to 13.2 percent of GDP, which is 0.6 percent lower than the original target. This sluggish revenue performance, leaves Uganda far worse off than its peers in the EAC[9]. External grants have not performed well either. Following last year's interruption to budget support payments to the Government in response to the uncovering of a major corruption scandal, this year may witness another shortfall in aid inflows due to the passing of the Anti-Homosexuality Act. By December 2013, foreign donors had disbursed only 29 percent of UGX 917 billion worth of the grants that had been budgeted for FY 2013/14. Few donors have so far announced outright cuts in response to the Anti-Homosexuality Act, but several have indicated that they are revising their overall assistance strategy to the Government.

Figure 11: Domestic Development Budget



Source: Ministry of Finance, Planning and Economic Development

Figure 12: Deviation between approved and executed budget



Source: Ministry of Finance, Planning and Economic Development

The revenue shortfalls have exclusively been absorbed through lower development spending, which is easier to postpone. As in many countries elsewhere, the Government has found it difficult to cut recurrent expenditure, since it is mostly comprised of salaries for teachers and civil servants. Instead, the Government has often decided to cut investment spending, which can be postponed more easily. Indeed, since FY 2008/09, the recurrent budget has been over-executed, while the development expenditure has fallen below its approved allocation in all but one year (see Figure 12). Similarly, during the first half of FY 2013/14, 49 percent of the approved recurrent budget had been released, with

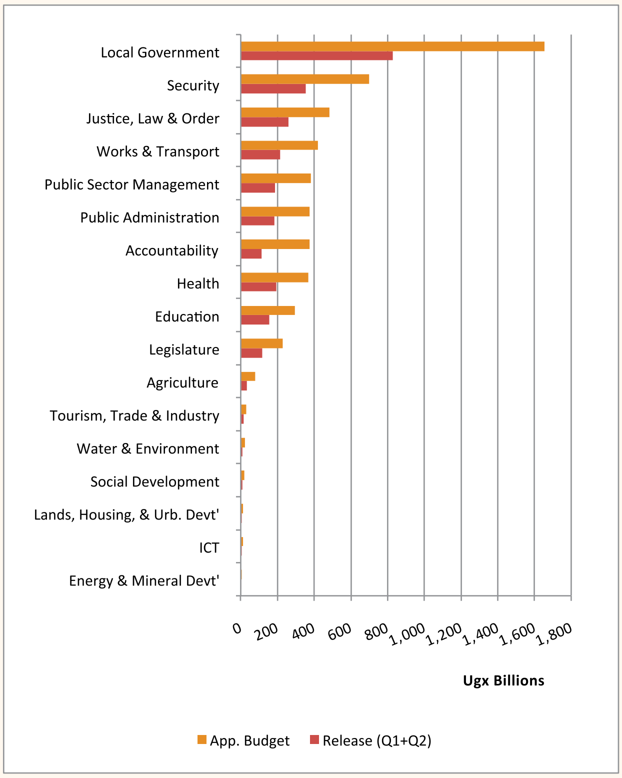
[8] Musisi and Richens (2014): "Uganda's Public Sector Borrowing Requirements, Financing Options and the Implications for Economic Performance", Ministry of Finance, Planning and Economic Development Working Paper.

[9] In FY 2011/12 domestic revenue as a share of GDP stood at 23 percent in Kenya, 17.6 percent in Tanzania, 14.3 percent in Rwanda and 14.8 percent in Burundi.

performance almost equally spread across the sectors (see Figure 13). Releases of development spending amounted to only 35 percent of the approved domestic development budget.

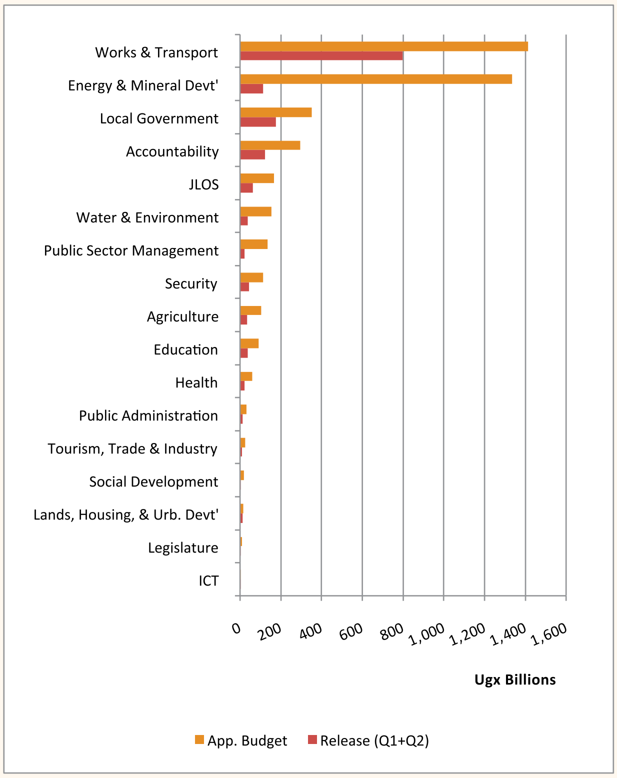
Like in previous years, development expenditure in FY 2013/14 is likely to be lower than had been budgeted on account of delays in the construction of the Karuma dam. The construction of the Karuma dam, accounted for 25 percent of the approved development budget (excluding donor projects). Though the implementation of some activities of this project have already started, there has been a delay of major construction work this year, partly due to the Government's recent decision to change the way it will finance the project. Without Karuma, 45 percent of the budget had been executed during the first half of the year. In particular, the works and transport sector, which accounts for 33 percent of domestic development budget, had executed 56 percent of its planned expenditure by December 2013 (see Figure 14). In addition, the government has requested Parliament to approve a supplementary development budget of almost UGX 140 billion to fast-track the implementation of the national ID project that foresees the creation of a biometric national identification register and the issuance of national identification cards for all Ugandan citizens. Overall, the development expenditure is expected to reach a value equivalent to 8.9 percent of GDP, which is 1.5 percentage points lower than in the approved budget.

Figure 13: Performance of the recurrent budget in the first half of FY 2013/14 (approved vs. released)



Source: Ministry of Finance, Planning and Economic Development

Figure 14: Performance of the development budget in the first half of FY 2013/14 (approved vs. released)



Source: Ministry of Finance, Planning and Economic Development

In contrast, recurrent spending is expected to be 0.6 percentage points higher than had been planned, as a result of supplementary expenditures. The Government's total supplementary request for recurrent spending submitted to Parliament in February 2014 amounted to UGX 220 billion. This is expected to increase recurrent expenditure by 0.6 percentage points of GDP above the originally planned budget of a value equivalent to 10.7 percent of GDP for FY 2013/14. The bulk of these additional resources have been earmarked to cover Uganda's military intervention in South Sudan (55 percent) and to provide training for the Uganda Police Force (27 percent). This will increase the share of recurrent expenditure to 55 percent of total budget, compared 49 percent that had been planned in the budget, while that of development expenditure declines from 51 percent to 45 percent.

Despite not spending as planned on critical projects, the overall fiscal deficit is expected to remain high. Total expenditure is expected to reach a value equivalent to 19.6 percent of GDP, almost a full percentage point lower than projected in the budget. However, due to the increase in recurrent expenditure and lower revenues, the fiscal deficit is still projected to reach a value equivalent to five percent of GDP. This would be 0.3 percentage points of GDP lower than in the approved budget, but still one of the largest fiscal deficits in more than a decade.

The overall deficit will be financed through an increase in domestic borrowing. Originally, Uganda's authorities had planned to finance the increasing deficit through the issuance of Government securities and specifically for the Karuma project to draw on Government savings accumulated from the oil related capital gains tax[10] . The postponement of major construction work at the Karuma site implies that the drawdown in savings will not materialize during FY 2013/14. Instead, the bulk of the fiscal deficit will be financed through greater domestic borrowing, projected to rise to 2.6 percent of GDP, the largest since FY 2010/11.

Table 1: Central Government Operations: FY2010/11 – FY2013/14

In percent of GDP	FY2010/11	FY2011/12	FY2012/13	FY2013/14	FY2013/14
				App. Budget	Proj.
Revenues and grants:	18.4	15.5	14.8	15.2	14.6
Domestic revenues	16.2	13.2	13.2	13.8	13.2
o/w Tax revenues	12.7	11.9	12.6	13.5	12.6
External Grants	2.3	2.3	1.7	1.4	1.4
Total expenditure	**22.8**	**18.5**	**18.9**	**20.5**	**19.6**
Recurrent	15.3	11.1	10.5	10.1	10.7
Development	7.1	6.9	7.6	10.4	8.9
Domestic Development	4.4	3.5	3.7	4.7	4.9
Donor Projects	2.7	3.4	3.9	3.8	3.8
Karuma Project	0	0	0	4.0	0.2
Overall balance	**-4.3**	**-3**	**-4.1**	**-5.3**	**-5.0**
External Financing	1.4	2.3	2.6	2.5	2.4
Domestic Financing	2.9	0.7	1.5	2.8	2.6
o/w Petroleum Fund withdrawals		0	0	1.2	0
o/w Domestic Borrowing	3.4	0	1.2	1.6	2.6
Memorandum items:					
Nominal GDP (Shs billions)	**39,086**	**50,172**	**55,574**	**63,679**	**62,712**

Source: Ministry of Finance, Planning and Economic Development, IMF, and World Bank

[10] These revenues arose from the taxes levied on the US$ 1.5 billion sale of oil exploration rights between Heritage and Tullow oil companies.

1.2. Economic outlook

1.2.1. Growth prospects remain robust as Uganda prepares for oil

The World Bank forecasts that the rate of growth of the Ugandan economy will rise above 6.2 percent in FY 2014/15, from 6.0 percent in FY 2013/14. The increase will be driven by sustained macro-stability and the ongoing implementation of infrastructure projects. This is a modest acceleration and still leaves the country's growth rate below the levels it has achieved in recent history. Over the medium term, if existing uncertainties related to fiscal management and key growth bottlenecks are addressed, Uganda's rate of economic growth should gradually increase up to or beyond the recent historical average of around seven percent. This increased rate of growth will largely be driven by an increasingly rapid transformation of production to higher productivity sectors, oil production and associated activities, and a higher level of integration between Uganda's economy and regional and world economies.

During FY 2014/15, stable inflation and a recovering external environment are expected to spur growth, if the increase in domestic borrowing does not raise interest rates and lead to a slowdown in private investments. Barring spikes in international energy and food commodity prices and the expected volatility in domestic food prices due to changes in weather, the inflation rate is projected to remain moderate at around seven percent over the next year. In this environment, monetary policy is likely to remain neutral. However, the drastic increase in Government borrowing from the domestic market could slow down the decline in interest rates observed during FY 2013/14 and result in reduced investment by the private sector. Private investment could also be affected by higher interest rates on foreign currency denominated loans. These loans have increased substantially in recent years due to low interest rates in many developed economies. As the stimulus packages in these economies are wound down and as central banks start to scale back quantitative easing programs, foreign interest rates will start to rise and entice Ugandan commercial banks to increase their level of foreign assets while reducing borrower's demand for foreign currency denominated loans.

The pattern of growth will remain similar to that realized during the past decade and a half. The predominant source of growth will be an increase of economic activity in the construction and services sectors, as manufacturing grows from a small base. Growth in the output of the agricultural sector will continue to be subdued, due to supply-side constraints. Though still accounting for only a small share of GDP, the mining and quarrying sector could be a significant source of further growth in coming years, as the sector's proven potential starts attracting increased attention from investors.

Uganda's rate of economic growth should gradually increase up to or beyond the recent historical average of around seven percent.

A view of Murchison Falls on the Nile River, one of the attaractions to boost foreign exchange revenues(Sheila Gashishiri, 2013)

Box 1: Assumptions for economic performance for FY 2014/15 and the medium term

Driven by an increase in public investment as the economy prepares for the impact of oil production, the real rate of growth of GDP is expected to accelerate to 6.2 percent in FY 2014/15, rising to 6.9 percent by FY 2015/16. With continued low international commodity prices, the rate of inflation is expected to remain in single figures. Public expenditure and net lending is expected to rise above 20 percent due to the acceleration in public investment, resulting in higher fiscal deficits over the next two years but declining thereafter as domestic revenue mobilization improves gradually. The current account is expected to deteriorate on account of a reduction in official grants and an increase in imports driven by a faster implementation of public investment projects. Together with a drawdown of Government savings to finance infrastructure investments, this is expected to lead to somewhat lower foreign exchange reserves in FY 2014/15-16, which should however quickly recover thereafter.

	FY2012/13	FY2013/14	FY2014/15	FY2015/16
National Income and Prices	**Actual**	**Proj.**	**Proj.**	**Proj.**
Real GDP Growth	5.8	6.0	6.2	6.9
Real GDP per capita	2.3	2.5	2.7	3.4
GDP Deflator	4.7	6.5	6.5	6.5
CPI (period average)	5.8	6.9	6.9	5.4
National Accounts				
Gross Domestic Saving	14.3	16.2	16.2	12.5
Gross Public Investment	6.1	6.8	9.0	6.7
Gross Private Investment	18.4	19.0	20.7	20.7
Public Sector				
Domestic Revenue	13.2	13.2	13.8	14.1
Grants	1.7	1.4	1.7	1.1
Total Expenditure and net Lending	18.9	19.6	22.8	20.5
Fiscal Balance incl. Grants	-4.1	-5.0	-7.3	-5.3
Balance of Payments				
Trade balance	-9.9	-8.7	-9.9	-8.5
Current Account balance, incl. grants	-7.4	-5.9	-7.9	-7.5
Foreign Reserves and Debt				
Gross foreign reserves (months of imports)	4.6	4.2	4.0	4.1
Public debt	32.9	33.6	36.9	40.2

Source: World Bank estimates based on Uganda MacMod (2014).

Other agencies seem to confirm the expected positive outlook of the economy. Even as Standards and Poor downgraded Uganda's rating from B+ to B on account of widening fiscal and external current account deficits, it foresaw solid growth to offset the risks of these imbalances (see Box 2).

Box 2: Conflicting Signals over Uganda's Sovereign Debt Rating, but positive outlook

On 17 January 2014, the Standard & Poor's (S&P) rating agency lowered Uganda's sovereign credit ratings from 'B+' to 'B' with a stable outlook. To some observers, this came as a surprise following the upward revision by the rating agency Fitch in September last year, which was reaffirmed last month.

The downward revision by S&P was mainly on account of a larger than projected fiscal deficit, following the suspension of aid and lower than expected revenue increases. Meanwhile, Fitch argued that the possible aid suspension in response to the Anti-Homosexuality Act would only have a limited impact on the budget, as the Government had greatly reduced its reliance on foreign aid. In addition, Fitch highlighted that the underlying balance which strips out one-off investments such as the Karuma and Isimba hydropower projects will only rise moderately from a value equivalent to 3.4 percent of GDP to 3.6 percent.

However, both rating agencies stress that the continued infrastructure investments and the solid medium-term growth prospects in Uganda partly offset the risks from fiscal and external imbalances. In an international comparison, Uganda's ratings are similar to several of its peers in Sub-Saharan Africa as depicted in the table below.

	Fitch Rating	S&P Rating
Uganda	**B Positive**	**B Stable**
Kenya	B+ Stable	B+ Stable
Rwanda	B Positive	B Stable
Ghana	B Stable	B Negative
Zambia	B Stable	B+ Negative

A better global outlook will also contribute to an increase in Uganda's exports to the US and the EU, as the economic growth of these countries appears to accelerate, which should drive an increase in international commodity prices. This could also help offset the potentially adverse effects of a protracted political crisis in South Sudan, which until recently was Uganda's fastest growing export market. In addition, increasing exports will help to counteract the widening current account deficit, which is set to increase as Uganda accelerates spending on infrastructure. The current account deficit will remain in the range of a value equivalent to 7-8 percent of GDP in FY 2014/15. The capital balance should remain roughly unchanged, as the expected decline in official aid transfers following the withdrawal of some donors due to the Anti-Homosexuality Act should be offset by a higher level of FDI, particularly in extractive activities. In the short run, the planned increase public investments will most likely also lead to a reduction of international reserves at the Bank of Uganda from a value sufficient for 4.6 to 4.0 worth of months of imports, as the Government uses a portion of savings to finance some of the initial infrastructure investments in oil (see below).

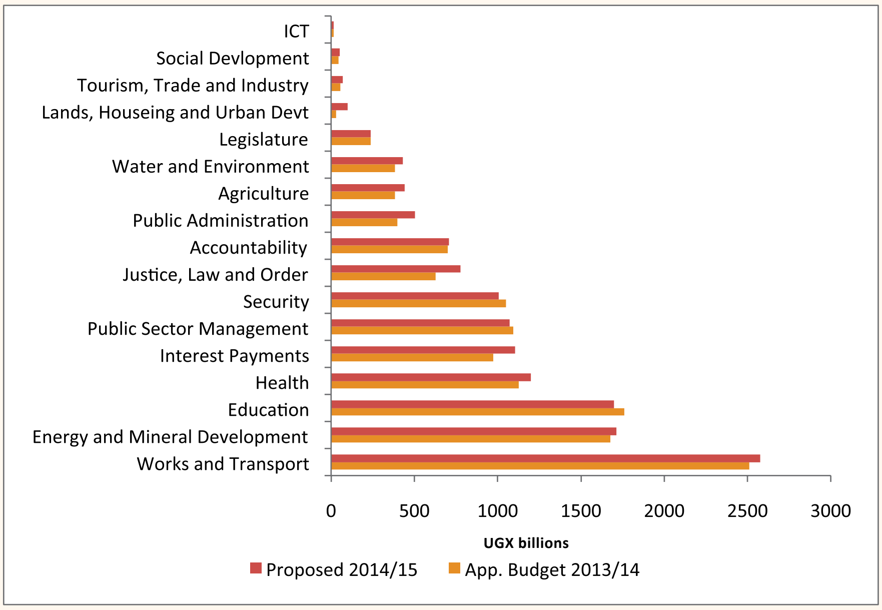
Fiscal policy is expected to be expansionary to address constraints to growth. Total expenditure is envisaged to increase from a value equivalent to 19.6 percent of GDP in FY 2013/14 to 22.8 percent in FY 2014/15. The major driver of this increase in expenditure is the acceleration of construction works on the Karuma and Isimba hydro-power plants. Once completed, these projects are expected to double Uganda's power generation capacity and ease doing business in the country. According to the 2014 National Budget Framework Paper, 30 percent of the budget will be allocated for roads and energy (see

Figure 15) in line with the Government's strategy to prioritize measures to address Uganda's infrastructure gap. Meanwhile, the proportion of the budget allocated for education will be reduced due to a decline in aid levels, with this proportion declining to 11.9 percent, compared to the 13.3 percent that had been budgeted in FY 2013/14. The proportion of the budget allocated for health will be 8.4 percent.

Domestic revenues are projected to reach a value equivalent to 13.8 percent of GDP, an uphill task given shortfalls in revenue collection performance in the current year. Uganda Revenue Authority has recently announced measures to boost revenue collection. These measures include among others the intensification of enforcement of tax compliance, sensitization on integrity and capturing of new tax payers in the informal sector, and the reduction of the clearance time in customs using electronic tracking devices and the roll-up of the new Automated System for Customs Data (ASYCUDA). However, despite higher revenues in FY 2013/14, the strong acceleration in infrastructure spending will still result in a sharply widening fiscal deficit to 7.3 percent of GDP, i.e. 2.3 percentage points higher than in FY 2013/14.

The overall deficit will be financed through an increase in external non-concessional borrowing and a drawing of Government savings. The Government recently decided to finance part of the Karuma dam and the Isimba dam through greater external borrowing, mainly with the Exim Bank of China (EBC) financing 85 percent of the Karuma and the Isimba hydropower projects. The remainder will be financed through the drawing of Government savings as originally intended.

Figure 15: Proposed Sector Allocations for FY 2014/15



Source: Ministry of Finance, Planning and Economic Development

Construction of roads in Mbarara, one of the key activities paving the way to higher investment and growth (Sheila Gashishiri, 2013)

The oil sector is expected to boost economic activity, particularly in the construction sector. The recent signing of a memorandum of understanding between the Government and a number of international oil companies[11] has been a significant milestone in initiating the development of Uganda's oil resources in the Albertine Region. It is expected that up-front investments amounting to a total value of US$ 8-12 billion will be required over the next five years to prepare Uganda for oil production. This includes the construction of a refinery with an initial capacity of 30,000-60,000 barrels per day (BPD) considered sufficient to cater for the region's demand for refined petroleum products; and a pipeline joining the oil fields to the Kenyan coast for the export of crude oil.

[11] The Government and the three international oil companies Tullow Oil (UK), Total (France) and the state owned China National Offshore Oil Corporation (CNOOC) recently agreed in a Memorandum of Understanding to build a refinery with a capacity of 30,000 - 60,000 BPD.

Box 3: Where could Uganda's oil produce jobs?

The 3.5 billion barrels of proven reserves could support production of 100,000-200,000 barrel per day (BPD) over 20 to 40 years depending on the speed of extraction. More than 60 percent of the oil rich Albertine Graben remains unexplored though the approval of a new legislative and regulatory framework in December 2012 paved the way for a new round of exploration licensing.

As a landlocked country, Uganda will face logistical challenges exporting its oil. The proposed refinery with a capacity of 30,000 - 60,000 BPD, is sufficient to cater for the region's demand for refined petroleum products. In addition, the Memorandum of Understanding between oil companies and GOU foresees the construction of a pipeline joining the oil fields to the Kenyan coast for crude exports.

Direct jobs in the sector - Actual oil production may not come on stream until 2018, but preparatory activities such as the construction of the pipeline and the refinery as well as the overall development of oil fields is expected to have a significant impact on the economy even before the production starts. The total cost to prepare the Albertine Region for oil production has been estimated at US$ 8-12 billion. Uganda's international oil companies estimate these investments could lead to the creation of 13,000 jobs at peak construction over the next 3-4 years. It is expected that over 60 percent of these jobs will be for craftsmen and technicians, 25 percent for the unskilled workers and 15 percent for the engineers and managers. After the construction phase and once actual production starts, the number of direct jobs needed for operating the refinery and the oil fields will decline to 3,000.

Jobs through linkages - There is a large potential for induced and indirect jobs once oil comes on stream. As oil companies start operating, there will be an increasing demand for several indirectly associated activities with the oil and gas industry, such as environmental services, manpower agencies, transportation and logistics, etc. Moreover, as part of the oil revenue is spent locally (either by the Government or by employees of the oil and associated industries) the number of induced jobs in sectors such as hotels, banks, insurance companies, or new schools will also rise considerably. Based on experience from other countries, the total number of direct, indirect and induced jobs generated could be in the range of 100,000-150,000.

Training is required to ensure Ugandans benefit - To ensure that the majority of these jobs go to Ugandans many existing craftsmen and technicians will have to be certified. In addition, the existing number of mechanical and electrical technicians in Uganda will not suffice to meet the demand of the construction activities in the Albertine Region, requiring several hundred new technicians to be trained. To maximize the benefits for Ugandans, a massive training initiative will therefore have to take place with a focus on vocational skills.
Source: World Bank staff estimates

According to the oil companies, construction is projected to start next fiscal year. With these projects and activities, it is highly likely that Uganda will experience a massive construction boom over the next five years. As a consequence, the demand for construction services is set to increase substantially and potentially increase jobs even before actual oil production starts (see Box 3).

Over the medium term, the economy could grow at a rate even faster than the historical average of seven percent. This will be achieved if higher productivity dividends are realized from accelerated expenditure on infrastructure through better public investment management. Better public investment management would require appropriate project selection to ensure that public expenditure is used to finance productive investments and the efficient and timely implementation of projects. The planned improvements to public investment management are an important step in achieving these objectives (see Box 4).

Box 4: Investing in public investment management will pay off, but where exactly are the gaps?

In 2011 the World Bank conducted a review of public investment management practices in Uganda, which highlighted a number of challenges:

- Few feasibility or pre-appraisal studies are performed by Ministries, Departments and Agencies (MDAs) of Government before projects proposals are submitted to the Development Committee (DC). The DC is in charge of deciding whether a project is included in the Government's Public Investment Plan (PIP).
- The DC does not conduct systematic cost and benefit analysis to prioritize and evaluate projects before deciding on their inclusion in the PIP. The DC does not possess the sufficient analytical capacity while there are no established templates of submission of applications.
- The PIP is a project database that includes not only investment projects but also Technical Assistance (TA) projects as well as spending of recurrent and even administrative nature.
- There is no real system of incentives to implement investment projects within budget and timeline. The procedure of submission of applications, and budget planning otherwise, are lax and frequently by-passed.
- The PIP does not require any realistic procurement plan and effective contract management plan. This should be critical to prevent excessive delays and allow for the management of ex-post price adjustment.
- Internal controls in project implementation seem to be quite weak and there is limited follow-up of value for money audits.
- Project evaluation only takes place for a range of larger projects based on simple comparisons of project costs, timeliness and deliveries, while only very few rigorous impact evaluations are taking place.

In order to address some of these issues it has been proposed to develop public investment guidelines and procedures through a DfID-financed TA project administered by the World Bank. In the medium term, this TA will consist in (i) cleaning and 'purging' the PIP and link it to the BOOST database; (ii) developing a project databank, complemented with step by step M&E; (iii) developing an associated training manual; and (iv) training core Government team of trainers in utilizing the database. In addition, the recent creation of a new department within the Budget Directorate in the Ministry of Finance, Planning and Economic Development (MoFPED) for Project Analysis, Assessment and Evaluation is a positive step. This department will work with all the appropriate parties involved in originating projects and the coordination with MoPFED to determine the feasibility and assess the relative cost-benefit of all project proposals.

Preparation for oil production could also drive an increase in the activities of the light manufacturing sector in Uganda. However, in the short term, it will also exert pressure on the country's external position. The increased demand for construction services is expected to benefit Uganda's construction industry, including the manufacturers of light construction materials. Following a number of recent investments in the steel and iron industry, Uganda could become a leading producer of steel and iron products in the region[12]. However, it is unlikely that Uganda will be able to meet all the increased demand locally. In fact, a recent study by Uganda's foreign oil companies[13] suggests that Uganda's industrial sector will face substantial supply-side constraints in meeting the total demand resulting from the various construction projects. Thus, many goods and services will have to be imported from abroad, which will considerably worsen Uganda's current account. This deterioration will be financed by continued large FDI inflows.

In addition to addressing infrastructure gaps, Uganda needs to place an increased priority on reforms aimed at improving the business environment to ensure that Uganda remains competitive in the region and accelerates private investments. In 2013, Uganda's ranking on the World Bank's Ease of Doing Business Index fell for the third consecutive year, dropping to 132 out of 189 countries. Uganda fares particularly badly in the area of the costs and complexity of procedures involved in establishing a business, securing electrical power, and trading across borders. Uganda's ranking compares very poorly with that of neighboring Rwanda, which has been very successful in establishing a business friendly environment, and thus placed as 32 in the report. In the past, Uganda has often enacted legislation without fully implementing and enforcing it. Enactment and enforcement are vital if the new laws are to genuinely improve the business environment. To this end, the Government must vigorously strive to formulate plans for the operationalization of these laws and to ensure that these plans are implemented.

1.2.2. Downside risks remain substantial

While the outlook for the economy is generally positive, there are a number of downside risks, the most important of which relate to fiscal management, both in the short and the medium term. First, following the donor cuts during FY 2012/13 due to the mismanagement of funds in various government ministries, several donors have recently announced a revision of their aid budgets in response to the enactment of the Anti-Homosexuality Act. It is not yet clear how this will affect total aid flows to the country. While some donors have indicated that they intend to divert funding from Government institutions to civil society organizations, others have suggested that they are reconsidering their engagement with Uganda altogether. This potential reduction in the level of aid to Uganda could have implications for the Government's commitment to accelerating spending on infrastructure and on the macro-stability of the economy more generally. If overall aid flows are maintained at current levels, with only the channel of transmission changing, the impact on the macroeconomic outlook may not be profound. Such re-channeling would not necessarily cause potentially damaging depreciation pressures on the shilling and a degree of continuity would be maintained. Another offsetting factor could be increases in FDI resulting from preparations for the exploitation of oil.

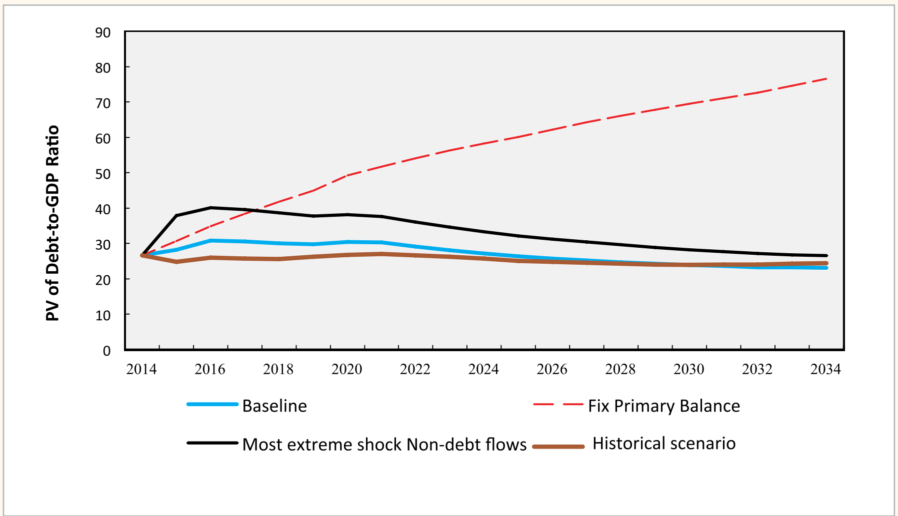
Second, with the Government's commitment to an enormous infrastructure development program, persistent shortfalls in revenue could worsen the fiscal deficits and make debt unsustainable. The increase in Government development expenditure can be justified on the grounds that it mainly represents one-off investments, which are necessary to address Uganda's infrastructure gap. For the same reason, the Government has had to raise its external non-concessional debt ceiling from US$ 1.5 billion to US$ 2.2 billion. Short term destabilizing effects on the macroeconomy could be mitigated because the planned projects have a high level of import content[14], which should prevent upward pressures on prices. However, in the absence of improvements in public investment capabilities, the increase in expenditure on infrastructure could quickly lead to the build up of the debt stock. Projected to reach 33.6 percent of GDP by the end of FY 2013/14, Uganda's debt level is still generally regarded as sustainable and considerably

[12] The completion of three iron and steel manufacturing plants east of Kampala have made Uganda's Roofings Group amongst East Africa's biggest steel producer by installed capacity.
[13] Total E&P (2014): The Industrial Baseline Survey.
[14] It is assumed that 90 percent of such projects are used to finance imports, leaving a mere 10 percent to be spent in the local economy.

lower than the average of 42 percent in the rest of Sub-Saharan Africa (excluding oil-exporting countries).

However, persistent high fiscal deficits of five percent and above will only be tenable if they lead to a strong increase in growth and if they promote strong socio-economic development in the country. In fact, according to the joint World Bank-IMF Debt Sustainability Assessment (DSA) from December 2013, maintaining a permanent primary deficit of 3.6 percent could raise debt levels significantly higher than any other scenario assessed[15] in the medium term (see Figure 16). In addition, if investments in infrastructure do not drive strong growth or are delayed as has been the case for the construction of Karuma, they could also result in a quickly rising debt-to-GDP ratio, most likely in excess of 50 percent, a key convergence criteria agreed upon in the East African Monetary Union Protocol last December by all East African Community member states.

Figure 16: Debt could be pushed beyond sustainable levels



Source: IDA-IMF Joint DSA, November 2013

A fisherman on Lake Victoria (Sheila Gashishiri, 2014))

Excessive domestic borrowing combined with a failure to increase revenues from domestic taxes poses a threat to macro-stability. The issuance of domestic debt for fiscal policy purposes will become a component of the Government's new debt strategy, which is currently being finalised by the Ministry of Finance, Planning and Economic Development (MoFPED). This represents a marked change in the Government's debt management framework. Prior to FY 2012/13, Government securities were only used as a monetary tool by the Bank of Uganda to manage liquidity levels in the economy, and not to finance the budget. Explicit issuance of domestic debt to finance the budget could greatly improve the transparency of fiscal policy and ultimately reduce the use of advances from the Bank of Uganda to the Government, which in the past were often used to fill short-term financing gaps. However, a high level of borrowing on the thin domestic capital market could also result in the crowding out of private investment as it pushes up interest rates, which have barely begun to respond to the easier monetary policies implemented during FY 2013/14. While the level of the overall public debt stock of Uganda appears to be manageable, interest payments already account for 7.8 percent

[15] Within the DSA, among the scenarios assessed include (i) the baseline scenario that applies macro variables to the best knowledge of how they will be evolving and how policy plans to respond to them; (ii) the historical scenario which applies the policy variables equal to the average attained over the past 10 years; (iii) the fixed primary deficit applies assumptions that can yield a same primary deficit through the projection period as would the last actual deficit observed, and (iv) the most extreme scenario that applies the most extreme outcomes out of the shocks such as reduced growth, reduced exports, reduced inflows, and a combination of all the shocks.

[16]As in the National Budget Framework Paper for FY 2014/15.

of the budget, almost as much as the total value of allocation to the health sector. If the proposed administrative reforms to the various tax codes materialize[16], particularly with regards to the fiscal regime governing natural resources and international tax agreements, these codes could result in increased tax revenue collection. However, it is unlikely that these measures will suffice, since a critical review of tax exemptions to large scale businesses is still required in order to bring domestic resource mobilization to levels similar to those in other EAC countries.

Third, while the Government is committed to the fiscal program, pressure to increase expenditures may intensify as Uganda approaches its next presidential and parliamentary general elections in early 2016. The increase in recurrent spending observed in FY 2013/14, in part resulting from an increase in allowances to the military and the police to ensure domestic security and prepare the 2016 elections, suggests that the electoral spending pressures are already on the rise. This may result in the delay of the implementation of some key programs, as has been discussed in previous editions of this Update (see Second and Third Uganda Economic Updates). In addition, financing these increases in recurrent spending through higher domestic financing could contribute to inflation spikes as observed in the aftermath of the 2011 election or lead to rising interest rates and crowd-out private investment.

Fourth, the accumulation of domestic arrears is a continued concern, as it undermines budget credibility and hampers policy analysis. By June 2013, arrears had increased to UGX 1,156 billion, which is equivalent to 2.1 percent of GDP, from UGX 803 billion as of end June 2012 (or 1.6 percent of GDP). While the Government introduced a treasury single account earlier this year, its implementation should be accelerated to capture all spending entities for it to address the problem of arrears. On the other hand, implementation of the integrated personnel and payment system (IPPS) may help to facilitate the timely payment of salaries and the elimination of ghost workers and pensioners from payrolls.

In addition to fiscal risks, Uganda remains vulnerable to climatic conditions and volatility in food prices, both of which could result in the destabilization of the macro-economy. Although the overall inflation rate has been relatively low in the recent past, food prices have remained volatile. With the lack of irrigation systems, food price volatility is likely to remain an issue. Moreover, a recent study jointly conducted by the Government and the International Food Policy Research Institute (IFPRI) shows a strong pattern of divergence in food price developments across the country. This suggests that food value chains continue to be insufficiently integrated. Supply-side constraints in the production of food can be very damaging in an agrarian-based economy such as Uganda's, as agriculture continues to be the major source of employment. In addition, if high food prices lead to increased inflationary pressures, it may force the Bank of Uganda to intervene by rising interest rates, with negative effects on the rest of the economy. Finally, the lack of integration of food value chains can also make it more difficult for the Bank of Uganda to implement monetary policy in response to food price shocks, as shocks are transmitted asymmetrically across the economy.

Lastly, events in South Sudan may have an ongoing impact on Uganda's economy. In recent years, the Ugandan and South Sudanese economies have become increasingly intertwined. The volume of trade between the two countries has risen dramatically over the last decade, as have financial flows in the form of FDI and remittances. Thus, the interruption of these cross-country flows as a result of a deepening of the conflict in South Sudan could have severe consequences for Uganda's economy. Although recent export data shows that exports to South Sudan have remained relatively resilient, a shut-down of the South Sudanese economy due to a deepening internal conflict could have a substantial negative impact, given that Uganda's exports to South Sudan contributed to 16 percent of all export earnings in FY 2012/13, more than any other single country. In addition, the impact of a prolonged crisis could be particularly high, since a large share of Ugandan exports to South Sudan occurs through informal channels, which are very sensitive to changes in local security conditions; as such exports incur limited fixed investment. Moreover, several thousand Ugandans have reportedly found work in South Sudan over recent years, a large proportion of whom send remittances back to their families in Uganda. According to data from the Bank of Uganda, Uganda received more than US$ 210 million in personal transfers in 2012 from South Sudan, the second largest source of remittances after the United Kingdom. Of course, a prolonged conflict could also result in a humanitarian crisis, which could create serious security and stability problems in Northern Uganda. The Government has already had to request a supplementary budget to a value of UGX 120 billion to pay for military security operations in South Sudan.

[16]As in the National Budget Framework Paper for FY 2014/15.

1.3. A more efficient pension system could support equitable old age protection and economic growth

Over the past two decades, the Ugandan economy has recorded both a strong growth in GDP and a strong per capita income growth, with increases in the latter averaging 3.5 percent per annum. With this growth, the country has also made significant achievements in the area of poverty reduction, with the proportion of the population living below the poverty line having declined from 56.4 percent in 1992 to less than 25 percent by 2009/10. While a number of economic shocks over the past five years have resulted in a slowdown in the rate of economic growth, the poverty rate has continued to decline, reaching 19 percent in 2013.

In spite of these achievements, Uganda is still a poor country, with an average per capita income of only US$ 510 in 2013. This means Uganda is among the 20 poorest countries in the world, and is ranked second last before Burundi amongst the East African nations. With its rapidly expanding population, approximately eight million of its citizens still live below the poverty line. In addition, while rapid growth has provided reasonable opportunities to members of poor households to escape poverty, approximately 24 percent of those who were slightly above the poverty line in 2005/06 had fallen back into poverty by 2009/10. Over the same period, approximately eight percent of those who were previously in the middle class had become poor. Indeed, according to the Poverty Status Report of 2012[17], the number of people who are still insecure (those who can meet their basic needs, but who have very volatile incomes) has more than doubled, from about six million in 1992 to 13.2 million today. This high level of vulnerability among the population is due to the negative impact of changes in employment status, droughts, and personal disasters, among other shocks.

Older people still represent a small percentage of the population, but they too are vulnerable to poverty. Today, 1.4 million people, or less than five percent of Uganda's population, are above the age of 60. Many people in this age bracket are vulnerable to poverty, with 65 percent suffering from old-age disability and 10.7 percent of them living alone. Approximately 15 percent of the households in the country are headed by an elderly individual, of whom almost 72 percent have responsibilities for caring for children and the sick. Furthermore, 2.5 percent of all households are elderly people who live on their own. The risks of poverty are even graver for elderly women, especially when they have lost their husbands. With women representing 63.2 percent of the total of the elderly, there are more widows than widowers (15.3 percent) among this group. In most Ugandan cultures, elderly widows are often left helpless and are stripped of their properties after the death of their husbands.

Like many governments across the world, the Government of Uganda recognizes that the establishment and implementation of social protection systems to reduce the number of people living in absolute poverty is an important means to eliminate extreme poverty. Properly implemented, such social protection systems can serve as

Areas like this in Karamoja would need special interventions to integrate them with fast growing parts of the country. (Great Lakes Film Production, 2012)

Uganda is among the 20 poorest countries in the world, and is ranked second last before Burundi amongst the East African nations.

[17] Government of Uganda (2012): Poverty Status Report

drivers for the achievement of inclusive, pro-poor and equitable growth. The multiple vulnerabilities faced by certain categories of the population, particularly the elderly, children, youth, women and people with disabilities, do not only affect their own socio-economic circumstances, they also have an impact on national development. The cost of failure to invest in social protection can be significant and long-lasting, as households forego nutritious food, pull children from school and engage in other negative coping strategies to deal with poverty and economic shocks.

The Government would have to put more effort in the implementation of initiatives. In terms of actual implementation, the Government's social protection initiatives have been described as "limited in scope and coverage and not coordinated with a unified framework, leading to poor implementation, duplication, wastage of resources and social exclusion[18]. " This is partly because the Government has failed to allocate sufficient resources to implement an effective social protection policy. In Uganda, total expenditure on social safety nets amounts to approximately five percent of the total value of public expenditure, which is equivalent to approximately one percent of GDP. This is significantly lower than the level of expenditure of many other Sub-Saharan African countries, with the regional average amounting to 2.8 percent of GDP. With this low level of allocation of resources, the overall rate of coverage of social protection programs intended to benefit poor and vulnerable households is also low, with a mere 4.6 percent of the population covered by social assistance or safety net programs.

The establishment of a comprehensive national social protection system that meets the needs of the poor and vulnerable will require a significant allocation of resources, a high level of commitment, and considerable thought. A well-structured pension system could form one of the several components of the social protection program that provides protection to one of the vulnerable groups, the elderly, as traditional social safety nets weaken.

Unfortunately, Uganda's pension programs still cover a small proportion of the population, are inequitable and fiscally unsustainable. In Uganda, less than 10 percent of the working age population is covered by any form of formal pension. The bulk of expenditure on social protection is utilized for the payment of public pensions to former civil servants, with the average level of retirement income provided through this scheme being equivalent to almost three times the average per capita wage. With this program providing such a high level of entitlements to a relatively privileged group, it is clearly not designed to provide protection to the poorest and most vulnerable members of society. In addition to the governance challenges facing the management of this public sector scheme, spending on this relatively privileged group absorbs a fairly substantial proportion of Government revenues. This spending is projected to increase rapidly, and could crowd out much needed resources, which could be used to cover the poor elderly and other vulnerable groups in society.

Furthermore, for Uganda to sustain rapid growth, the financial sector in Uganda will need to operate more efficiently, as inefficiency in this sector remains one of the key binding constraints to investments and growth Although Uganda's efforts to develop the banking system have been relatively successful, only 180 people per 1000 hold a bank account, a far lower number than in neighboring Kenya, where the figure is 650 people per 1000. Intermediation of available resources within the banking system is also problematic, as seen by the large margins between savings and lending rates. At the same time, the total value of domestic savings in Uganda amounts to the equivalent of only 13 percent of GDP. While these figures are similar to those in a number of other African countries, Ugandans save far less on average than individuals in fast growing economies in East Asia and in the middle income countries that Uganda aspires to emulate. Past growth diagnostics across the world show that no country has sustained high levels of economic growth when it has a low level of low domestic savings[19]. Encouraging pension savings and utilizing the existing pension assets in the country more effectively could be an important catalyst to raise the overall level of savings in the country.

Part 2 of this update discusses how the pensions system could support the objective of promoting equitable protection against poverty amongst the elderly, while helping to mitigate the fiscal risk and to support financial sector development, among other benefits.

[18] Government of Uganda (2014): Draft National Social Protection Policy

[19] Commission on Growth and Development (2008), The Growth Report Strategies for Sustained Growth and inclusive Development

Mrs. Tumusiime, wife to Adonia, selling ghee along Ishaka-Bushenyi road, to feed her family (Sheila Gashishiri, 2014)

Adonia Tumusiime, 67, has been living in Gayaza a suburb of Kampala for the last two months. Since he retired from the Kampala District Local Government 12 years ago, he has come to live in this suburb with the family of his distant relative. It is too expensive for him to make the many journeys from his home in Bushenyi District in Western Uganda to Kampala as he follows-up his pension payment for this year. Back home in Bushenyi, Adonia leaves behind his wife and two school age grandchildren tilling the land. When he eventually gets his Shs 150,000 per month worth of his pension, the money will help him pay for the scholastic materials for his two grandchildren, who came under his care 4 years ago when their father (Adonia's son) passed away. He can also buy seedlings for the next planting season.

Adonia is one of the 275,000 pensioners who can receive pensions from the public pension scheme once retired. Although it is not a lot and in spite of the difficulties in accessing it, the pension will support him to meet some of the basic needs for his family. Other pensioners would have saved with the National Social Security Fund or some of the existing voluntary schemes that have been set up by various employers. Unfortunately, in totality, only two percent of the elderly population in Uganda is covered by some form of pension protection. The rest of the population age at their own peril – surviving through family support where it still exists or toiling away in subsistence activities, particularly in agriculture. Can the on-going pension reforms address old age poverty and vulnerability for a larger part of the population, as it has done for a privileged few like Adonia?

PART 2

PENSIONS:

REDUCING VULNERABILITIES AT INDIVIDUAL LEVEL WHILE SUPPORTING ECONOMIC GROWTH

Cissy Kiguli, matooke farmer in her farm in Mpanganti -Zirobwe in the Luwero district, 64 kilometers from Kampala

PART 2: PENSIONS: REDUCING VULNERABILITIES AT INDIVIDUAL LEVEL WHILE SUPPORTING ECONOMIC GROWTH

- A coherent policy of social protection, including for the elderly, can promote social transformation and accelerate economic development.
- Uganda's pension coverage is too limited to achieve the primary objective of social protection. Both the Public Service Pension Scheme and National Social Security Fund cover less than 10 percent of the working age population in Uganda, mostly urban workers.
- The bulk of Uganda's spending on social resources, amounting to 0.4 percent of GDP, is for the public pensions for former civil servants, which constitute less than 2 percent of the population and are relatively well paid. These costs will rise over time, absorbing scarce Government resources, which could be directed to more vulnerable groups.
- Apart from providing a social safety net for the elderly, under the right conditions, well managed pension systems can contribute to economic growth and increase savings.
- Uganda is already taking steps to start building an effective pension system, but challenges remain in ensuring transparent and proper governance of the pension funds; achieving efficiency objectives, building up the institutional capacity, and managing the fiscal pressures due to expenses to existing pensions and the new public pension scheme at the same time.

Many countries have developed pension systems that provide protection against extreme poverty and vulnerability in old age. The experience of these countries clearly demonstrates that the initial establishment of an efficient and effective pension system is not easy. Indeed, for many countries, the process of establishing such systems has been protracted. The establishment and implementation of such a system in Uganda can benefit from experiences elsewhere, including from within Africa. This Economic Update is intended to provide input to the deliberations on pension reform in Uganda focusing on the questions: (i) why should Uganda be concerned about pensions? (ii) what lessons can Uganda learn from other countries in its endeavors to establish a more effective pension system? (iv) what is being done in Uganda? And (iv) what are the challenges and risks involved in this reform process and how can they be mitigated?

2.1 Why should Uganda be concerned about pensions?

Uganda has been building its pension system for a considerable period. The country's first steps to establish a pension system began almost 80 years ago. The oldest scheme, the Armed Forces Pension Scheme, was first implemented in 1935 to provide social protection to retired soldiers. Following the establishment of this scheme, a number of other schemes have since been created, including the Public Sector Pension Scheme, which was first established in 1946 to provide retirement benefits to public servants. Later, in 1985, the National Social Security Fund (NSSF) was established to provide social security to private sector workers. In addition, other voluntary schemes have been established by a range of employers to provide retirement benefits to their employees. However, these private sector schemes have not yet been subject to regulation, and little is known about their parameters, scope and performance.

Uganda's pension schemes face a range of challenges that prevent them from achieving their stated objectives. Uganda's pensions system currently comprises of four different types of pension schemes (see Table 2). In the public sector, there are two schemes, one of which is the Armed Forces Pensions Scheme, which is drawing on the Government's budget, but for which limited information is available for analysis. Amongst the challenges that affect the public sector schemes are lack of timely access to benefits and access by unqualified beneficiaries through the enrolment of ghost pensioners, partly due to lack of proper records. As a result of these and other issues, the fiscal burden of these schemes is increasing, while they are still failing to achieve their goal of providing social protection to all members of society. Private pension schemes have been negatively impacted by low returns resulting from the poor management of pension assets. Little is known of the voluntary occupational plans, but the lack of regulation in the past has left them open to the risks of assets being used by the plan sponsor rather than invested in the interest of plan members.

Table 2: State of Uganda's Pension System

Scheme	Armed Forces Pension scheme	Public Service Pension Scheme	National Social Security Fund (NSSF)	Occupational Retirement Benefit Schemes
Legal Framework	Armed Forces Pensions Act 1935 (CAP 298)	Pensions Act 1946, Amend 1994 (CAP 286)	NSSF Act 1985 (CAP 222)	Trust Law. Retirements Regulatory Authority Act 2011
How many people are covered?	Unknown	275,000 workers ~ 2% of Uganda's workforce	450,000 workers ~ 3% of Uganda's workforce	Unknown
Who is covered?	Military officers	All civil servants (Central Government, police and prison officers, judiciary, doctors, primary and secondary school teachers)	Private sector employees of formal sector companies with more than 5 employees	Employees of private sector firms that voluntarily choose supplemental pension arrangements, beyond NSSF
How are benefits funded?	National Budget	National Budget	Workers' accumulated savings from mandatory contributions (5% of salary by employee and 10% of salary by employer)	Worker's accumulated savings from voluntary contributions (generally employer contributions)
Who is covered?	Old age (retirements); invalidity; survivorship; short-service gratuities	Old age (retirements); invalidity; survivorship; short-service gratuities	Old age (retirements); invalidity; survivorship; withdrawals; emigration grant.	Unknown
What is the design of the schemes?	Defined benefit	Defined benefit	Defined contribution	Defined contribution defined benefit (depending on plan)
What does the design imply for workers?	Worker receives benefits based on length of service and salary during service	Worker receives benefits based on length of service and salary during service. Survivors receive benefits in case of death before retirement	Worker receives lump sum based on returns earned on contributions Survivors receive benefits in case of death before retirement	Workers receive benefits at retirement based on individual scheme rules
How are benefits received?	Part lump sum payment and annual pension payments	Part lump sum on retirement and annual pension payments	Lump sum on retirement	Lump sum and/or annual pension payments (depending on scheme rules)
What is the funding status today?	Unfunded: Requires budget allocation (undisclosed)	Unfunded: Requires budget allocation of UGX 250 billion[20] or 0.4% of GDP per year	Funded: Funds stand at UGX 3 trillion (or 5% of GDP), which are managed by NSSF and invested in various assets.	Mostly funded: Members savings estimated at UGX 0.25 trillion managed by the pension scheme or external service providers

[20] Estimated total pension payment for FY2013/14 according to World Bank modeling

In its current state, it is highly questionable whether the country's pension schemes are achieving the objective of providing a solid basis for an effective social protection system for elderly citizens. It is also questionable whether public resources are being used equitably; whether these systems can be sustained in the long term; and whether they are contributing optimally to the country's development.

2.1.1 Limited pension coverage, limited protection against poverty in old age

Experiences around the world demonstrate that a well-functioning social security system can reduce the risk of a significant proportion of the population falling into poverty in old age. This can be achieved in various ways. Either a non-contributory, social pension can be paid to all or subset of elderly citizens. This can have significant implications for a great number of people other than the direct recipient of the pension, as benefits are commonly shared with the recipient's household members, through contributions to food costs, clothing and school materials to members of the recipient's extended family. For example, in South Africa, members of families of the recipients of pensions are 11 percent less likely to become poor, while girls living in a household with an older woman who receives a pension are on average 3-4 centimeters taller than those in households without a family member in receipt of a pension. Similarly, in Zambia, a pilot social pension scheme to benefit older people caring for orphans resulted in improved school attendance. Alternatively, social safety nets can be targeted to poor households, which would in turn provide protection for older family members (as is the case in the Bolsa Familia system in Brazil). The policy to adopt by a country depends on its social and poverty conditions.

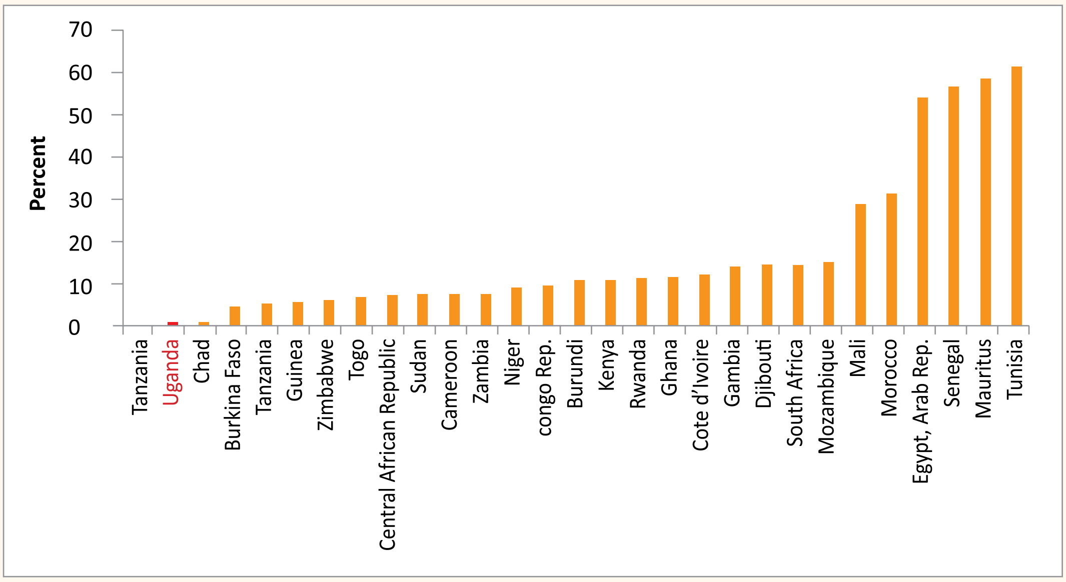
The observed impacts of well-functioning social security systems provide a strong justification for the efforts of governments to build effective systems that provide benefits to all elderly people. All elderly people, regardless of their employment history or of their level of contribution to pension schemes, should have the means to sustain themselves either through contributory schemes or through the receipt of social safety nets pensions provided through reliable, efficiently administered, sustainable, and affordable schemes. Such systems enable aging members of society to face their future with realistic expectations and a certain level of security, without placing an unbearable burden on Government finances or younger generations.

Despite the clear need to address the needs of the elderly and other vulnerable groups, Uganda's social protection system still fails to achieve its primary objective of providing protection against poverty and vulnerability in old age. Even though it is expected that the elderly will become less productive as they age and withdraw from mainstream economic activities, the majority of Uganda's elderly have not accumulated significant savings during their working life and therefore lack the means to effectively sustain themselves and their dependents in their old age. Thus, as the productive capacity of the elderly declines, they become increasingly dependent on others for support. Elderly citizens who are not supported by extended family or community institutions must therefore continue to engage in strenuous work, mainly in subsistence agriculture. Their susceptibility to ill-health coupled with the high cost and lack of availability of medical care suited to their needs exacerbates their vulnerability.

At present, only two percent of people above retirement age receive any form of pension income (see Figure 17). Currently there is no national, social safety net scheme to provide security for the elderly and other vulnerable groups. While the Government has implemented a pilot non-contributory social pension scheme, this presently covers only 17 districts. Other elderly people are supported through food aid in the north of the country. To address this lack, the Government has formulated the Draft National Social Protection Policy to address the need for coverage for elderly citizens and other vulnerable groups.

Building own savings is another step to building well-functioning pension schemes. Around the world, in addition to providing old-age pensions, many governments have recognized the need to encourage citizens to accumulate their own savings to sustain themselves beyond retirement, with this being widely recognized as an important step to ensuring a decent income in retirement. Despite the broad recognition for the need for pension schemes to be augmented by personal savings, only less than 10 percent of the working age population in Uganda currently participates in formal savings schemes for their old age (see Figure 18). Based on the 2010 Uganda National Household Survey (UNHS), Uganda had a total of 15.2 million workers, of whom 2.5 million were employed in the formal sector. The current pension system covers only about 450,000 of these workers (18 percent of all private sector

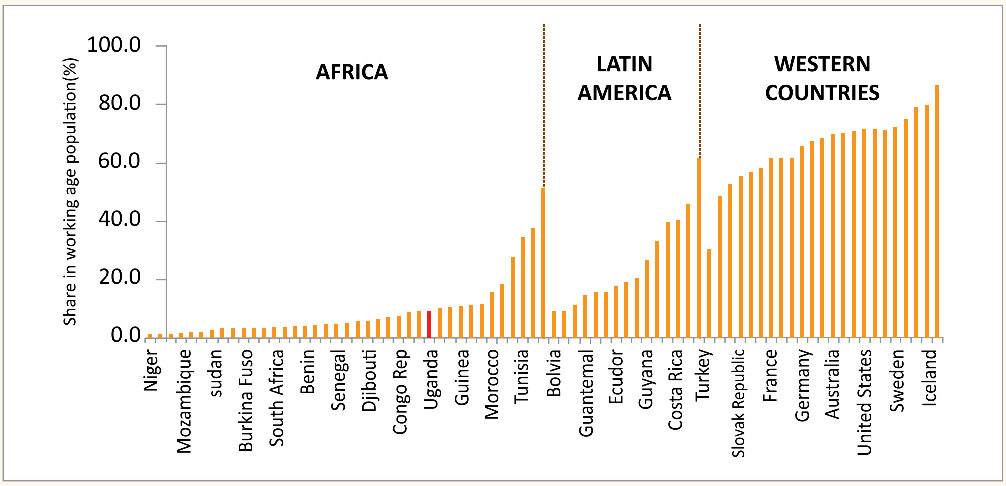
Figure 17: A comparison of African countries: Uganda has among the lowest share of population above legal retirement receiving pension



Source: World Bank Pension Data bank, www.worldbank.org/pensions

workers) through their contributions to the National Social Security Fund (NSSF). In addition, a small proportion of workers in the public sector participate in pension schemes, with approximately 275,000 teachers and civil servants qualifying for the Public Sector Pension Scheme. That leaves a large proportion (71 percent) of wage earners who do not contribute to any form of pension scheme. This level of coverage is comparable to many other African countries, but is on average less than half of the rate of coverage in Latin America. On average, 44.7 percent of workers in Latin America contribute to a pension system, with a number of countries, including Chile, Uruguay, and Costa Rica, achieving a rate as high as 70 percent. Pension coverage is closely positively related to GDP per capita levels and hence coverage will rise as Uganda develops. However, a broad range of policies could be put in place to encourage pension savings rates to increase from broadening social security coverage to developing savings schemes from the informal sector, to measures promoting greater financial inclusion.

Figure 18: Pension savings low: Uganda's workers could build stronger first step to descent retirement



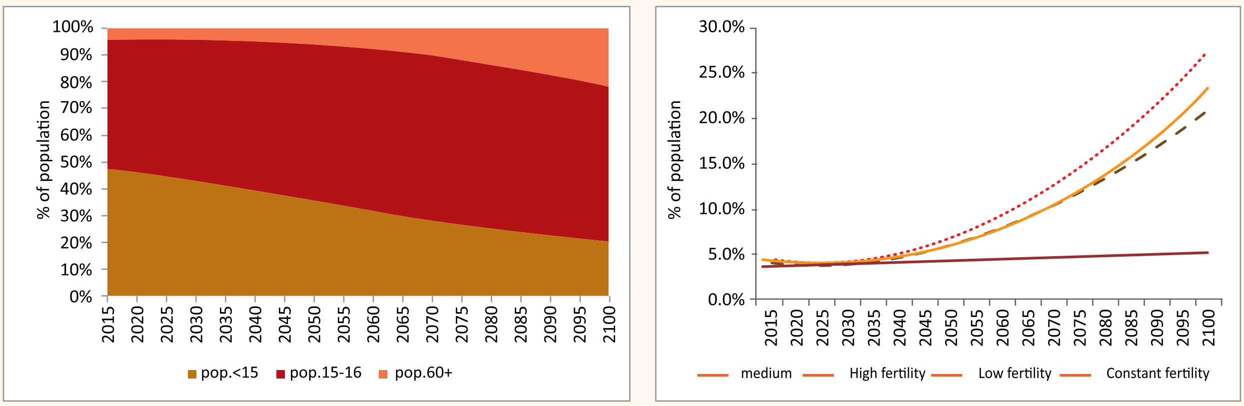
Source: World Bank Pension Data bank, www.worldbank.org/pensions

In general, the main limitation of social insurance schemes in Uganda is their limited rate of coverage. Formally employed workers in the public and private sectors, most of whom live in urban centers, are covered, but this includes less than 10 percent of the working population. In Uganda, the majority of the working population consists of rural smallholder farmers, informal sector workers, and self-employed. Generally, these members of society are not covered by any form of comprehensive social protection system. According to the Urban Labor Force Survey 2009, among employers and self-employed workers outside the agricultural sector, 68 percent and 83 percent respectively were engaged in the informal sector[21], with the 2009/2010 UNHS showing that there were a total of 1.8 million informal businesses operating in the country. The majority of informal businesses were in the agricultural sector (27 percent) followed by trade and services (24 percent); and, far behind, mining and quarrying (one percent) and fishing (one percent). In this context, the establishment of a pension system that covers rural and informal workers will be particularly challenging in Uganda.

2.1.2 Old age social protection: The need will grow with demographic change

With approximately 50 percent of Uganda's population below the age of 15, it is a fair question to ask whether the country needs to worry about pensions at this point in time. Uganda is still young and has not yet begun the demographic transition that has characterized many developed and emerging nations. However, as demographic changes progress, the average age of the Ugandan population will increase, with a corresponding increase in the number of the country's vulnerable elderly citizens. Projections by the United Nations Department of Economic and Social Affairs projects that by 2050, more than two billion people worldwide will be aged over 60. Of these, 80 percent will live in developing countries, with the number in Uganda amounting to almost six million. As fertility rates and the average size of families decline, the elderly will constitute an increasingly large proportion of the total population. In Uganda, it is projected that the rate of growth of the elderly population will be a full percentage point higher than the average rate of population growth, which is predicted to reach 2.6 percent. With this rate of growth, the absolute number of the elderly in Uganda is estimated to reach four times its current level by 2050. This is quite close to the average increase for Africa as a whole, for which the absolute number of the elderly is projected to be five times the current level at the same point in time (see Figure 19).

Figure 19: Projected increases in the proportion of Uganda's elderly population



Source: United Nations, Department of Economic and Social Affairs, Population Division (2011). World Population Prospects: The 2010 Revision, CD-ROM Edition

Social and economic factors will also drive the need for the provision of formal pensions. In the past, extensive social and extended family networks have limited the need for old age social protection systems. As is the case in many African countries, Ugandans have a strong tradition of caring for their aging relatives. Yet the Government's Draft National Social Protection Policy Framework for Uganda accepts that the social networks that have traditionally provided protection for the elderly and members of other vulnerable groups have weakened over time due to a number of factors, including the high rate of rural-urban migration; high levels of unemployment and underemployment;

[21] Uganda Bureau of Statistics (2009): Labour Force Survey Report

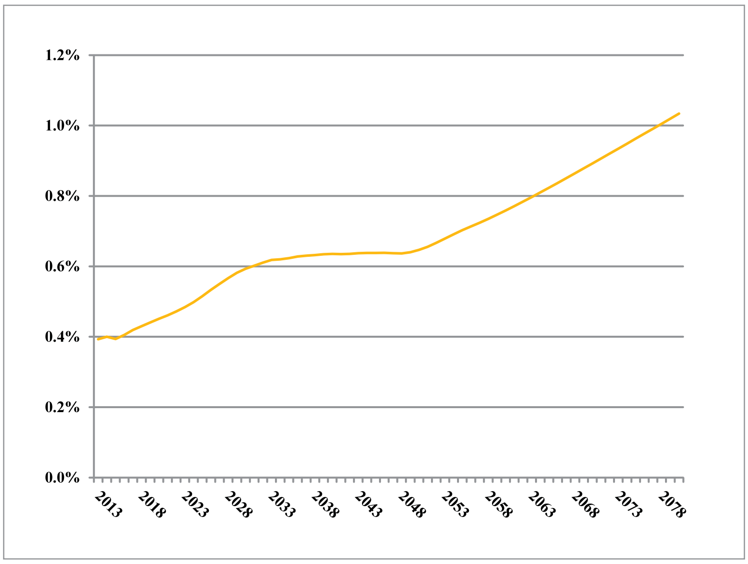
the HIV/AIDS pandemic; civil conflicts and widespread poverty.

Therefore, while the need for a pension system may not seem particularly pressing at present, it will become increasingly so into the future. It would be highly advantageous for the Government to take advantage of the current demographic sweet spot, characterized by a young workforce and a proportionately small number of those of pensionable age, to develop a functional pension system. This would facilitate the development of such a system at a time when associated costs would be relatively low, hence avoiding the old-age trap that is afflicting many developed countries and a number of developing countries, where the elderly constitute a much larger proportion of the population. Similarly, given that the accumulation of savings to achieve security in old age should be a lifelong endeavor, measures to ensure that the working population increases their level of savings should be implemented now in order to take advantage of current demographic circumstances. Global experience shows that measures to address the care and security of the elderly will be far more effective if they are implemented at such a point in the country's development.

2.1.3 The current pension system: Neither fiscally sustainable nor equitable

In spite of its low coverage, the public pension scheme cost 0.4 percent of GDP per annum, which is equivalent to the budget for primary health care. This cost is bound to increase in future to cover the entire health sector budge today. As stated above, one of the main components of Uganda's current pension system is the Public Service Pension Scheme. This scheme covers all 275,000 civil servants and an undisclosed number of staff of the armed forces, representing less than two percent of the population. In spite of this low rate of coverage, Government spending on this scheme amounts to 0.4 percent of GDP, a figure projected to more than triple in the long run[22] (see Figure 20). As a percentage of the Government budget, expenditure on this scheme is set to increase from the current level of 2-3 percent to 10 percent over the long run, which will place intense pressure on the Government's ability to allocate funds for other key social programs. The Government's accrued liabilities to members of the public sector pension scheme, which measures the present value of the benefit promises made to date, amount to US$ 4.9 billion, or more than 23 percent of GDP. The experience of other countries in Africa shows how expenditure on pensions can rise rapidly, even in young countries. For example, Government expenditure on pensions has risen as a proportion of GDP by almost three times in Mali and Kenya, from a figure equivalent to 0.5 percent of GDP in the mid-1990s to almost 1.5 percent in 2010.

Figure 20: Projected Government annual expenditure on public sector pensions (percent of GDP)



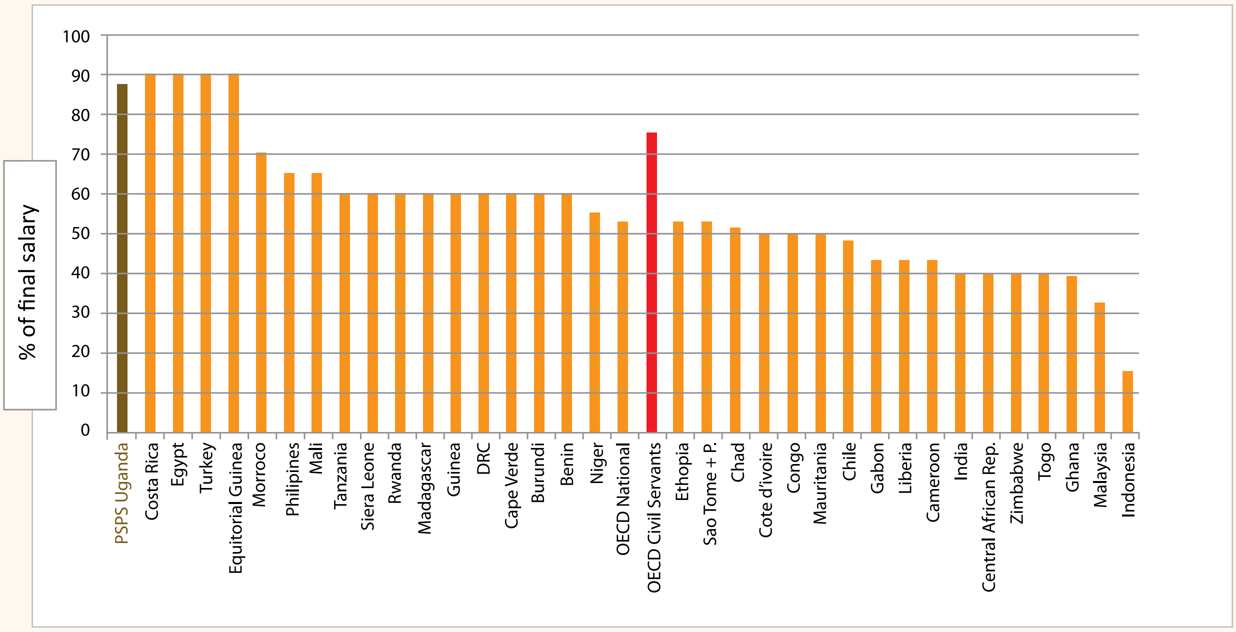
Source: World Bank PROST Modeling

The Treasury currently pays 0.4 percent of GDP for pensions every year (Great Lakes Film Production Ltd, 2014)

[22] World Bank PROST model. Uganda spent 0.4 percent of GDP of 2012 on pensions for civil servants and other special schemes. Assuming no change to the system and its governing parameters over the next 50 years, this amount will almost treble to 1.1% of GDP. As data was not made available, the costs of the Armed Services Pension Scheme are not included in these numbers.

The fiscal burden created by Uganda's public sector pension scheme is due to the generosity of entitlements provided through the scheme. The Ugandan public sector pensioner receives a pension with an average value of up to 87 percent of their final salary before retirement. This replacement rate is very high when compared to similar schemes in other countries, where a range of 60 to 70 percent is more common (see Figure 21). This, together with the increasing size of the civil service and the increasing average age of its employees, is increasing the cost of this scheme, raising questions regarding its sustainability. Without reform to reduce the generosity of the scheme (technically referred to as parametric reforms), the fiscal burden of pension liabilities will increase, which could constrain the Government's ability to finance equally important priorities for public expenditure, including the expansion of social protection programs for the poorest and most vulnerable members of society.

Figure 21: Replacement rate: Uganda pays a relatively high pension to its civil service retirees compared to national and civil service schemes in other countries



Source: World Bank Pension Database

Governance problems within the pension sector exacerbate the fiscal burden. In general, the Government acknowledges that corruption is one of the main challenges facing the country and has put in place an extensive legal framework, policies and institutions to improve overall governance. Specific to the provision of pensions under the public sector pension system, the system is negatively impacted by organized syndicates comprised of public and private sector officials strategically located within different Government and private sector institutions who conspire to embezzle public funds and, more generally, by the limited institutional capacity and lengthy bureaucratic processes that delay sanctioning of those involved in corrupting the scheme and encourage impunity..

Another issue relates to constraints on access to pensions affecting those possibly qualified to receive them due to a lack of proper records, a breakdown of the infrastructure for administering the scheme, and the lack of a system to facilitate access for those living in remote locations. In the past, delays to payments due to these factors have been the main source of arrears for the Government. There have also been cases of culpable mismanagement of pension records, particularly through the enrolment of ghost pensioners in the system, which places additional pressures on Government resources. According to a report by the Auditor General submitted to Parliament in December 2012, a total of UGX 165 billion (US$ 66 million) was lost in the period from 2009 to 2012 as a result of the fraudulent enrolment of 3,000 ghost pensioners. The problem led to the suspension and delay of pension payments for approximately 60,000 retirees for up to a year.

Finally, the cost of the scheme for the armed forces is unknown. While it is drawing from the consolidated fund, information on the armed forces pensions is not available, creating fiscal uncertainties due to the fact that these costs cannot be accurately determined and that future costs cannot be accurately projected.

The degree to which the current public pension system represents equitable spending of public resources is questionable. For a pension scheme that covers less than one percent of the population, the high level of expenditure on pensions results in a redistribution of public resources towards a higher earning group, which is less likely to fall into poverty in old. Household surveys suggest that public servants are less likely to be poor compared to their counterparts in private sector wage or self-employment age (see Table 3). Effectively, the rest of the economy, including those on low incomes and in poverty, is subsidizing the better-off public pension recipients, with the average pension paid by the public sector scheme (US$ 1,370) amounting to a value equivalent to almost three times the average wage.

Table 3: Poverty profile by employment status of household head

		Poverty estimates		
	Population share (%)	Head count	Poverty gap	Squared poverty gap
Self-employment	79.7	33.6	9.5	3.8
Government employment	4.7	7.2	0.9	0.2
Private employment	11.9	24.0	6.7	2.7
Others	2.4	36.2	12.3	5.4
Inactive	**1.3**	**19.2**	**3.3**	**1.2**
Uganda	100.0	31.1	8.7	3.5

Source: Uganda Bureau of Statistics (2004/05): Uganda National Household Survey

2.1.4 Well-managed pension systems could potentially contribute to the development of financial systems and savings

In addition to their role as a vital component of a social protection system, under some circumstances, well-managed pension systems can play an important role in the development of financial and capital markets, which in turn contributes to economic development and growth. The strongest evidence for this is found in Latin America, with Chile being one of the best researched cases. One study[23] presented evidence of a direct impact from pension reform on total savings and hence on economic growth, estimating that approximately half of the increase in total savings between 1981 and 2001 (4.9 percent of GDP) was due to these reforms. In other countries, the evidence of an impact on savings, financial market development and growth is mixed but generally positive, especially in the case of developing countries[24]. For example, a link between the growth of pension assets and the increasing duration of Government securities can be found in Kenya. Likewise the launch of mobile phone-based pension savings schemes has moved savings into the formal financial system[25].

Uganda's policy makers recognize the link between well-managed pensions and financial sector development. These possible benefits of pension reform to the financial sector are identified in the Ugandan National Development Plan (2010/11-2014/15), which includes the stated aim of developing a competitive, effective and well-governed pension sector in order to develop the financial services sector and to ensure the long-term supply of capital. A key underlying critical function

[23] Corbo, V. and Schmidt-Hebel, K. (2003): Efectos Macroeconómicos de la Reforma de Pensions en Chile

[24] For example, López Murphy and Musalem (2004) show that the introduction of mandatory funded pension systems contributed to higher savings in a sample of developing countries that they analyze.

[24] Source Retirement Benefits Authority, Kwena, R., M., Turner, J., A., (2013): Extending Pension and Saving Scheme Coverage to the Informal Sector: Kenya's Mbao Penion Plan.

of a good pension system is to allow savers consume fairly the same amount after they have stopped working, as they did during their working time, so as to have smooth consumption pattern through their lifetime.

To realize the link between pensions and financial sector development, Uganda would need to build a robust legal and regulatory framework, financial infrastructure, and an array of financial instruments. It should be stressed that the link between pension reform and financial market development cannot be taken for granted. Rather, a number of enabling conditions need to be in place for a positive synergy to occur. These conditions include a strong commitment from the Government to ensuring the development of a robust legal framework and financial infrastructure, a strong supervisory framework and the adequate availability of financial instruments. While the pension reform process in Uganda is intended to foster these conditions, continued commitment from the Government, financial sector regulators, the Bank of Uganda and broader stakeholders will be necessary to ensure that the enabling environment is sufficiently robust to allow the pension system to flourish.

However, currently existing pension assets in Uganda are not being put to best use. Uganda has one large mandatory social security fund, the National Social Security Fund (NSSF), which has a monopoly on the collection of contributions from formal sector workers and their employers and on the investment of the funds so derived. Holding a monopoly, the NSSF has had limited incentives to improve efficiency, reduce administrative costs, improve corporate governance and maximize returns. Given that the fund has assets equivalent to a value of UGX 3 trillion under its management, representing more than 25 percent of the financial system's total assets and equivalent to approximately five percent of GDP, the NSSF is the largest investor in the country. As such, the manner in which it manages its investments has a significant potential impact on growth and development. The fund owns 80 percent of listed equities and approximately 25 percent of Government securities, which significantly affects the liquidity of the domestic markets.

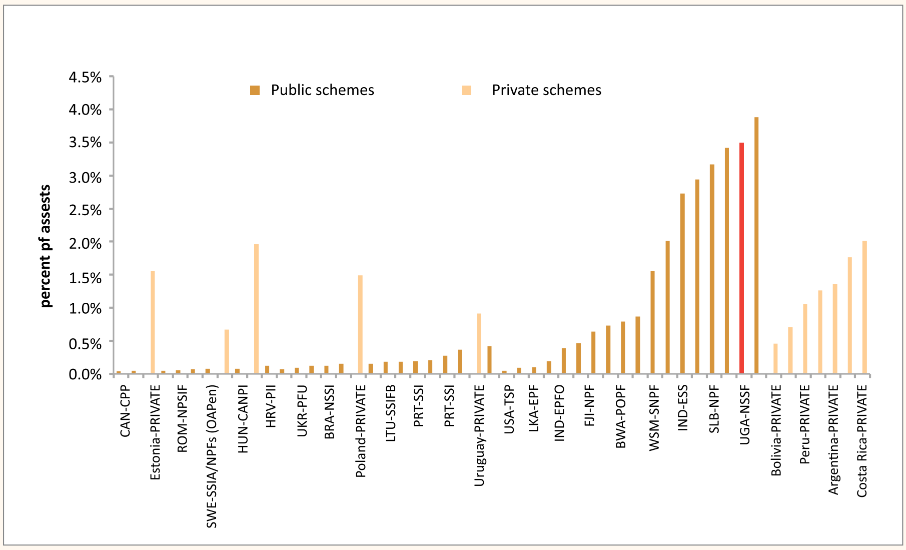
Inefficiency in the NSSF is also demonstrated by the high costs associated with its administration. Indeed, a recent study[26] found the NSSF to be one of the most expensive public pension funds surveyed in the world, taking the size of the fund, the level of economic development and other factors into account (see Figure 22). These costs significantly reduce the ultimate value of pension savings and entitlements. It is estimated that if applied over a full career span, for every additional one percent annual charge on assets, the ultimate value of an individual's pension is reduced by 20 percent.

The NSSF, at the Workers House, Kampala, is currently the only mandatory body responsible for private sector workers' pensions

Holding a monopoly, the NSSF has had limited incentives to improve efficiency, reduce administrative costs, improve corporate governance and maximize returns.

[26] Sluchynsky, O., (2014): Defining, Measuring and Benchmarking Administrative Expenditures of Public Pension Programs.

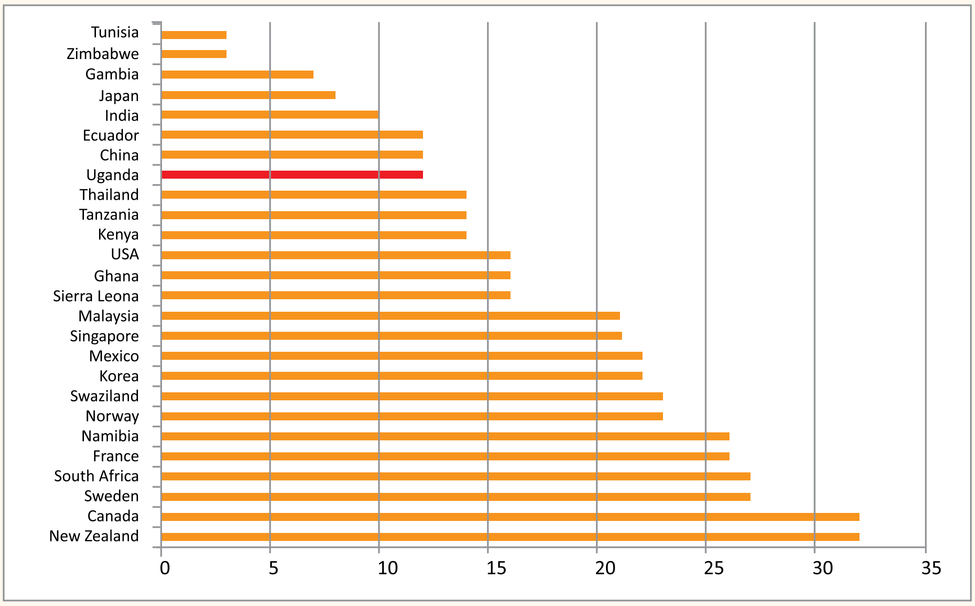
Figure 22: Costs of managing pension liabilities (percentage of total assets)



Source: Sluchynsky, 2014

Past problems are closely related to the poor quality of governance of the fund, which includes the culpable mismanagement of assets. The NSSF ranked very low in a recent worldwide survey related to levels of transparency and quality of governance in the management of public pension reserve funds (see Figure 23). Criticism includes the fact that members of the tripartite board are largely appointed on the basis of their position within organizations they represent, rather than for their knowledge of investment issues, with these organizations representing Government, employers and, predominantly, trade unions, despite the fact that union members represent only 15 percent of the workers enrolled in the NSSF and that only seven percent of NSSF funds are unionized. In addition, investment decisions have to be cleared by the Ministry of Finance, Planning and Economic Development, which can cause transactions to be blocked and/or delayed.

Figure 23: Costs of managing pension liabilities (percentage of total assets or IPDs)



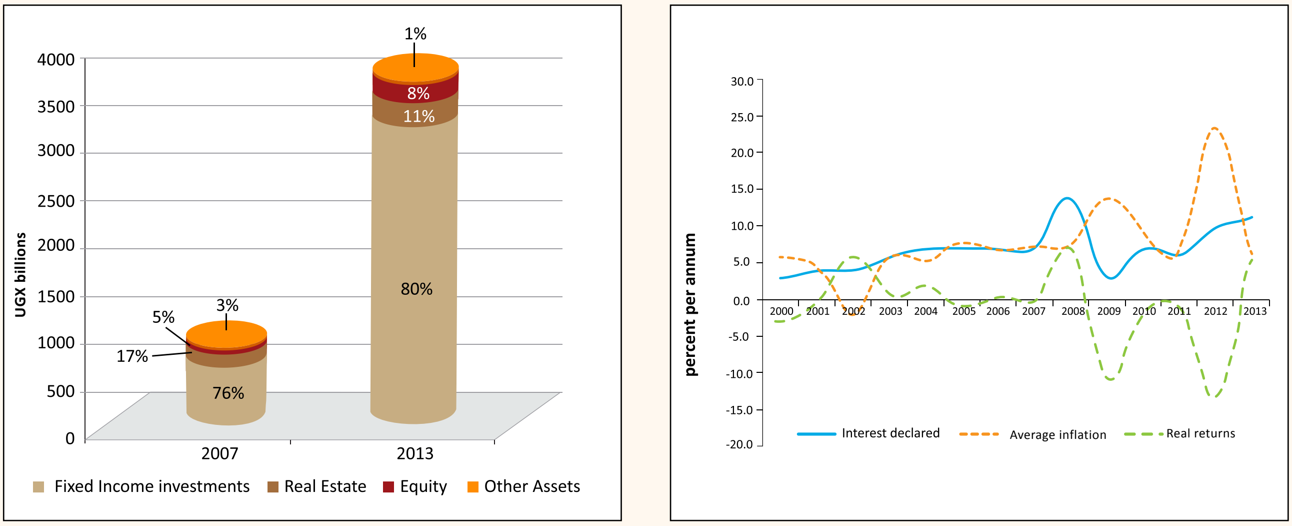
Source: Musalem and Souto 2012[27]

[27] Musalem A.R., Souto P. (2012): Assessing Governance and Transparency of National Public Pension Funds.

It should be noted that over the recent years, the performance of NSSF has improved. Under new management, which has set clear investment targets and established a model portfolio, returns on savers' contributions increased from three percent in 2009 to 11.3 percent in 2013. Unfortunately, this was also during a period of high inflation, implying that real returns on investments remained negative for most of this period. While administrative charges also declined to around 1.75 percent of assets, they still remain well above international standards, where central collection systems can cost well below one percentage points of assets.

Currently, the investment portfolio is being diversified into longer duration assets and external fund managers have been appointed. However, investments remain concentrated in bank deposits and Government bonds, with a large exposure to property and limited, heavily concentrated equity investments (see Figure 24). Given that the NSSF holds 80 percent of listed shares in Uganda and more than one-quarter of all Government securities, it operates in a context of extremely limited liquidity, making it very difficult for the fund to trade without having an impact on market prices. Rather than delivering a return to members, funds have been used as a source of financing for the Government, often resulting in distorted rates in a small, illiquid market. These funds are often used to provide financing for the achievement of social or development objectives or are directed towards illiquid, non-transparent investments. With the lack of a vibrant secondary market, pension assets have not facilitated access to long-term capital by borrowers, nor have they contributed to improving the liquidity of the financial markets or to lowering interest rate margins.

Figure 24: NSSF Portfolio – changed in size, but not in composition or return



Source: National Social Security Fund Financial Statements

Low returns on retirement savings and methods of payment undermine the security of pension savings in NSSF. The poor returns derived by this fund have a direct negative impact on the value of members' retirement savings, making it impossible for these members to maintain pre-retirement consumption levels. In addition, the NSSF currently only pays out entitlements in the form of a lump sum, rather than an annual pension income, further reducing the level of security provided to members. Overall, mismanagement of NSSF funds in the past has also contributed to a lack of public confidence in pension savings systems.

2.2 How countries are building effective pension systems

The test for any effective pension system is whether it provides old-age income security for the population it covers. For this to be realized, the pension system should consist of five key characteristics: (i) coverage; (ii) adequacy; (iii) sustainability; (iv) security; and (v) efficiency. Achieving all these five elements of a pension system in an economically and politically acceptable manner is not easy. Therefore, despite the potential benefits, many countries face difficulty in making the changes necessary for the establishment of more efficient and effective pension systems.

In recent times, reforms have been undertaken in numerous countries around the world to address these challenges and to try to make pension systems more effective. Though the demographic pressures are less urgent in Africa than in other parts of the world, pension reforms have been taking place to address the same issues as in Uganda: Low coverage, unsustainable expensive public service schemes and the inefficient use of existing pension assets. Reforms range from the introduction of non-contributory social pensions in countries such as Botswana and Namibia, to full scale Chilean-style reforms in Nigeria. Where the specific reform measures addressed themselves to the above-mentioned five key characteristics of an efficient pension system is summarized in Table 4 below.

Table 4: Pension reforms in African countries

Principle	Reform effected	Country examples
Coverage	Expand social assistance to poor and vulnerable households	Universal schemes: Cape Verde, Mauritius, Namibia, Seychelles Means tested or other targeted schemes: Kenya, Lesotho, Swaziland Pilot schemes: Ghana, Nigeria, Zambia Pension tested schemes: Lesotho, Swaziland Household targeted schemes: Ethiopia (productive safety net programs, direct support component), Kenya (Hunger Safety Net Program)
Adequacy	Expanding coverage of formal firms and designing schemes for informal sector workers	2011: Kenya Mbao pension developed by Retirement Benefit Authority (RBA) for informal sector pension savings via mobile phones 2008: Namibia Agriculture Retirement Fund introduced to cover farmers
Sustainability	Changed public sector pension schemes from PAYGO to contributory schemes	Botswana, Cape Verde, Senegal, Sierra Leone, Zambia
Security	Pension regulator established	2001: Kenya RBA established to supervise all pension funds 2004: Nigeria established National Pension Commission under the Pension Reform Act 2008: Ghana established the National Pensions Regulatory Authority 2008: Tanzania Social Security Regulatory Authority established
Efficiency	Reform of monopoly social security funds	2004 Nigeria: Structural reform to replace state run mandatory defined benefit DB civil service and private sector system with a funded define contribution DC 2008 Ghana: Multi-tier system, with part contribution to individual fund managers introduced 2011 Malawi: Parliament adopted a bill establishing a system of mandatory individual accounts for most workers in the country 2012 Kenya: Contracting out of part of social security contributions from National Social Security Fund permitted

Source: World Bank reports

2.2.1 Coverage

The principle of adequate coverage pertains to ensuring that all individuals have support in their old age. Some countries have developed universal programs to ensure that all the elderly, irrespective of their previous employment status, are catered for through the provision of uniform pensions. This basically serves as a safety net for the elderly, who may not have put aside other forms of savings, to ensure they are not left in extreme poverty. Other countries have implemented these programs through the use of different types of testing for legibility for the programs.

In a number of Sub-Saharan African countries, including Botswana and Namibia, universal old age pension schemes are financed through general taxation, with these schemes covering all residents and providing them with an annuity. In South Africa, a social assistance scheme, financed through general taxation, covers elderly individuals (aged 60 or more) with low means, providing them with an annuity. In these countries, the percentage of those over the age of 65 receiving old age benefits is in the range of 75-90 percent, compared to ranges from around only five percent in Uganda and Tanzania to 12 percent in Ghana. These schemes ensure that the elderly who do not participate in contributory, employment-based social security and private pension schemes are covered. However, these schemes are characterized by high costs and are thus usually adopted by countries with relatively high per capita incomes.

Lesotho is a good example of how pension reform involves trade-offs between the different goals of the pension system, with coverage and adequacy having to be balanced against cost and sustainability (see Box 5). Determining where poverty is concentrated and how the elderly in the population are looked after must be analyzed properly to understand whether directing programs to this group is the best use of scarce Government resources. Targeting these programs towards poor people above a given age is one way to control costs. Efforts to extend the coverage of contributory schemes to all formal sector workers and to create savings or pension schemes for informal sector workers are other means of extending coverage in the medium to longer term.

Box 5: Lesotho's non-contributory social pension ensuring universal, but costly, coverage

Introduced in 2004, Lesotho's social pension scheme is intended to provide basic income assistance for individuals not covered by an extensive network of voluntary occupational schemes for formal sector workers. Everyone over the age of 70, except those already receiving a Government pension, is registered with photo identification. The applications are screened and information filed in a dataset, which is updated on a monthly basis to capture the latest entries and exists. Based on the register, monthly disbursements of M450 (US$ 43) each month are made through 300 post offices throughout the country. It normally takes around 10 days to reach all the beneficiaries.

The Ministry of Finance and Development Planning administers the scheme. This ministry also determines the benefit level. By 2008, the proportion of the population above legal retirement age receiving a pension was over 80%.

The scheme is financed out of the state budget. Even though the program is pension tested, meaning that only those not already receiving a pension from other sources are eligible, the cost is equivalent to 1.8% of GDP. This is due to the relatively high level of the benefit, which has a value equivalent to 35% of per capita GDP, compared to other social pensions in the region, where the value ranges from between 5-25%. Another challenge is the problems of ghost pensioners, resulting from the non-reporting of deaths by next of kin.

Source: Stewart, F.,Yermo, J. (2009): Pensions in Africa; with updates from World Bank database.

2.2.2 Adequacy

Adequacy of pension benefits ensures that the elderly have at least enough to meet their basic needs. In this case, adding contributory pension savings on top of the basic minimum provided by social pensions is required to ensure a higher level of security in old age. While encouraging or requiring pension savings within the formal sector can be achieved through appropriate regulation to ensure that workers contribute, the challenges are greater in countries with a large informal sector and with a largely agrarian economy. Under these circumstances, it is necessary to develop schemes specifically designed for the many small firms in the informal sector and for groups such as farmers operating in rural areas.

Despite the challenges involved, there are good examples of schemes developed for these groups in other countries. For example, a scheme specifically for agricultural workers has been developed in China, even though this provides only limited benefits. In India, the New Pension System, which is mandatory for civil servants and voluntary for the rest of the population, has been adapted into what is known as a 'Lite' form specifically to meet the needs of workers in rural areas, with less stringent contribution and withdrawal requirements and utilizing community-based associations for collection. In Kenya, the pension regulator has been instrumental in the development of a pension savings system, Mbao, which leverages the growing mobile money network (see Box 6).

Box 6: Mbao: How innovation is helping Kenya expand pension coverage and adequacy

Pension reforms in Kenya started about 15 years ago, with the establishment of the pension regulator, the Retirement Benefits Authority of Kenya (RBA).

Like in many other African countries, Kenya's informal sector employs about 80% of the labor force, which presented a major challenge to expansion of pension coverage. The Kenya National Social Security Fund was covering workers in firms with more than 5 employees. This left a large proportion of the labor force uncovered.

After 10 years of building experience in licensing, regulating and supervising retirement benefit funds, including administrators, fund managers and custodians, the RBA established the Mbao pension plan in June, 2011. This was done under an arrangement between RBA and National Federation of Jua Kali Associations.

The Mbao program covers medium-and-small micro enterprises and Jua Kali associations. Members commit to save at least about 20 Kenyan shillings a day or $6.00 per month towards retirement. Mbao members can make payments through the leading mobile transfer services with payments through M-PESA and Airtel money transfer services. The strong payments and financial inclusion infrastructure in Kenya helps this to work well.

Within a month after establishment, the scheme had 42,000 members and has since grown to be the largest Individual Pension Plan in Kenya. A similar scheme is currently being developed between the RBA and "Matatu" (taxi and minibus) operators.

The challenge for schemes such as Mbao going forward will be how to balance flexibility with adequacy. Schemes for the informal sector rightly need to be flexible due to the needs of the targeted group and the objective of encouraging these voluntary savings. However, if money is removed before old age it can be questioned whether these really are pension schemes or rather another form of longer-term savings vehicle.

Source: Kenya Retirement Benefits Regulatory Authority

2.2.3 Sustainability

This aspect pertains to the capacity to deliver the promised level of retirement benefits and to the affordability of the funding of associated schemes, whether the benefits are provided by governmental, private sector or individual finances. As expenditure on pension schemes has increased, pension reform has been a focus of policy action in developed countries, particularly those with rapidly aging populations. In these countries, particularly in Europe, countries are reforming their systems to reduce benefits and increase retirement ages, among other changes, to make pensions schemes more affordable. In other regions, such as Latin America, the most significant change has been the shift from systems that define workers' benefits (defined benefit) to those which defines some form of contribution by the worker and his or her employers to their retirement package (defined contribution schemes).

In this regard, many countries have followed the lead of Chile, which replaced its social security system with a mandatory, privately managed, defined contribution, individual account pension scheme in the 1980s. A major reform of the system took place in 2006, with the reintroduction of a basic pension for those who had made insufficient contributions to finance a minimum pension. In order to achieve sustainability, several countries in Africa, such as Cabo Verde (see Box 7), have reformed public service pension plans, expenditure on which constitutes the bulk of their total expenditure on pensions. National schemes have also been reformed to ensure their long-term fiscal sustainability. For example, parametric reforms were undertaken to the national, contributory Seychelles Pension Fund to tackle its fiscal unsustainability, with on-going reforms directed at improving the level of equity of the fund.

Box 7: How Cabo Verde managed to reduce public pension costs

Cabo Verde previously had two separate contributory pension schemes - the Adminstracao Pulbica (AP) scheme for civil servants and the Instituto Nacional de Previdencia Social (INPS), a mandatory social security scheme for private sector workers. In 2006, a law was passed to integrate the two schemes. Fiscal relief were achieved by moving new entrants to the civil service to the INPS, which had a lower level of benefits, although these benefits were still generous by international standards, with an 80 percent replacement rate compared to the 100 percent paid under the AP scheme. Parametric reforms were also implemented at the INPS, with these reforms including reducing the maximum replacement rate, increasing the minimum contribution period from three to 15 years and changing the benefit calculation base from best three years to best 15 years of salary. However, additional reforms are still required to make the fund sustainable over the long-term. Savings initially amounted to a value equivalent to 0.1 percent of GDP, rising to around two percent at the peak.

In addition, cost savings were achieved though economies of scale derived from merging the funds, given that Cabo Verde is a small country and the number of participants in each of the schemes was limited, with around 55,000 contributors in the INPS and only around 10,000 in the AP scheme. These contributory schemes are supported by a non-contributory universal pension, which is means tested and provides a benefit with a value equivalent to 22 percent of GDP per capita, at a total cost of 0.4 percent of GDP.

In this case, moving civil servants to the national system met with general acceptance, as they gained health benefits through participation in the national scheme. Merging schemes has been met with more resistance in other countries, with many public sector schemes, particularly in Africa, remaining independent.

Source: World Bank Studies

2.2.4 Security

In this context, security involves minimizing the risk that funds that have been or should have been accumulated to provide retirement benefits are lost or misappropriated before the benefits are delivered. Several countries are improving the security of pension savings through the licensing of pension schemes and the implementation of oversight through the establishment of dedicated pension regulatory authorities, as has been the case in Ghana, Kenya and Tanzania, though some of these regulators are proving to have greater powers in practice than others. Pension regulators have played an important role in cleaning up the pension system and ensuring the long term growth of savings in countries such as India (through the Pension Fund Regulation and Development Authority) and Kenya (through the Retirement Benefits Authority).

Box 8: How Kenya's Retirement Benefits Authority securing pension savings

Following the promulgation of the Retirement Benefits Act (1997), the Kenya Retirements Benefit Authority (RBA) became active in 2000. Prior to this, all pension and provident schemes operated without clear regulatory guidance. In spite of the huge growth potential of the industry, it had been neglected. It also needed reform in view of the growing real and potential risk of the mismanagement of existing pension schemes. The RBA was mandated by law to "regulate and supervise the establishment and management of pension schemes," with a clear goal of protecting the interests of members who contributed to schemes.

How did it secure pensions?

RBA established standards to govern the establishment and management of pension schemes, starting with the registration of schemes and service providers. It introduced a certification process for trustees, which although appointed by members and employers, had to be approved by the RBA, for various private sector schemes that were being established as trusts. It enforced the holding of annual general meetings, mandated disclosure retirements, organized training for scheme members to increase their awareness of their rights, introduced a whistle blower system for fraud, adopted a risk-based model of supervision, and simplified dispute resolution processes. It also began the outsourcing of asset management, the custody of scheme assets and, in some cases, scheme administration. An initial focus of the authority was on the improvement of the funding levels of schemes to ensure they could pay promised benefits.

What has RBA achieved?

The measures implemented by the RBA have increased the level of confidence in saving for retirement due to the creation of a regulatory body; increased member awareness through board representation; improved investment portfolio returns and increased diversification through the use of independent investment managers; increased the security of scheme assets through the separation of asset custody to independent custodians; and increased transparency and accountability through annual audited financial statements and other statutory returns and regulatory oversight. Today, Kenya has about 1,240 pension schemes operating alongside the NSSF. Since its creation and the passing of pension legislation and regulation, levels of professional misconduct have declined substantially, with transparency and whistle blowing making it much harder for pension plan sponsors to divert scheme funds into unauthorized business or engage in other misconduct.

The RBA also prepared the ground for the liberalization of the NSSF in the context of challenges such as the high cost of administration; poor record keeping; only offering small lump-sums benefits; imprudent investments; qualified accounts and insufficient accountability, all of which had inevitably led to a loss of confidence in the scheme. In 2013, the NSSF was converted from a provident fund into a pension fund, with two tiers comprising the mandatory 12 percent of pensionable earnings to be deposited with NSSF, while the additional savings could be out-sourced by employers. Challenges remain for the RBA, not least of which is ensuring the compliance of NSSF with the regulatory environment. The authority is also refining its risk-based approach to supervision to better target problematic funds.

Source: Kenya Retirement Benefits Regulatory Authority

2.2.5 Efficiency

When it comes to the efficiency of pension systems, the main objective is to maximize the level of retirement benefit generated from the contributions by optimizing investment returns and minimizing costs. This is especially important in defined contribution schemes, in which the employees bear the ultimate risk, since there is no guarantee regarding the performance of the fund and since they have no recourse to the employer.

The main thrust of pension reforms in Africa has been to address the inefficient management of social security assets. Such inefficiency has been characteristic of the management of several schemes in the past, with many failing to deliver a real return on assets. To address this, some degree of outsourcing of central social security assets has been adopted by several countries in the region. For example, contributions into the social security fund in Kenya above a minimum earnings limit can be contracted out and managed by alternative schemes which meet certain criteria. Similarly, in Ghana, five percent of mandatory contributions can be managed by private, occupational schemes. Elsewhere in the world, social security fund and provident funds, such as the Central Provident Fund in Singapore, are increasingly using external fund managers to invest at least a portion of the assets under their management, while others, such as the Kosovo Pension Trust, outsource the management of all of the assets for which they are responsible. In other countries, such as Nigeria and Malawi, increased competition is achieved through the establishment of privately managed individual pension accounts. However, a strong enabling environment, with sufficiently developed capital markets and a robust regulatory and supervisory oversight, amongst other factors, are necessary to make these individual account systems work.

Box 9: Nigeria: Trying to improve efficiency through competition and choice

The Contributory Pension Scheme (CPS) was established by the Pension Reform Act in 2004. This is contributory, fully funded, privately managed defined benefit (DC) system based on individual accounts. Membership is compulsory for public sector employees and for those private sector employers with more than five workers. A minimum of 7.5 percent contributions are made by employers and employees (tax free) and voluntary contributions are allowed. Benefits (tax free) are received in the form of an annuity or program withdrawal and a certain amount as a lump sum. All retirement savings account holders who have contributed for 20 years are guaranteed minimum pension specified by the Government.

Pension funds can only be managed by pension fund administrators, chosen by the employee, which have obtained a license from the regulator, the National Pension Commission - which also controls their fees and regulates the asset classes they can invest in. Nigeria was the first country in sub-Saharan Africa to introduce a pension system based on 'Chilean style' individual, funded accounts. The question which arises from this experience is whether the Nigeria had the infrastructure to support the operation of such a system. There has been some criticism that Nigeria was at a different level of development to Chile when the reforms were introduced (in terms of economic, social and pension system development) and there was a lack of governance, records, financial institutional capacity, and market development. Certainly the diversification of pension assets has not been achieved to the extent expected and most assets remain in Government bonds. Consistent data on administrative costs and returns is not disclosed in Nigeria making it difficult to establish whether the costs benefit of the reforms has so far been positive.

Moreover, as 90 percent of individuals work in the informal sector, the new system is unable to meet the fundamental goal of providing most Nigerians with access to formal social security programs. Some have therefore argued that Nigeria still needs a basic social pension – which the Chileans have introduced through reforms to their own system.

Comprehensive revisions of the Investment Regulation for the mandatory funds were undertaken between 2006 and 2012 in order to protect the ultimate beneficiaries. This reform aimed at (i) expanding the investible window for pension assets, considering the huge and growing inflows of monthly contributions; (ii) ensuring that more pension fund investments are directed to the real sector of the economy – for employment generation and infrastructure development of the country; and (iii) enhancing risk/return profile of the portfolios so that pension funds earn 'real returns' in the long term. New asset classes such as infrastructure were introduced, but so far the funds remain concentrated in bonds.

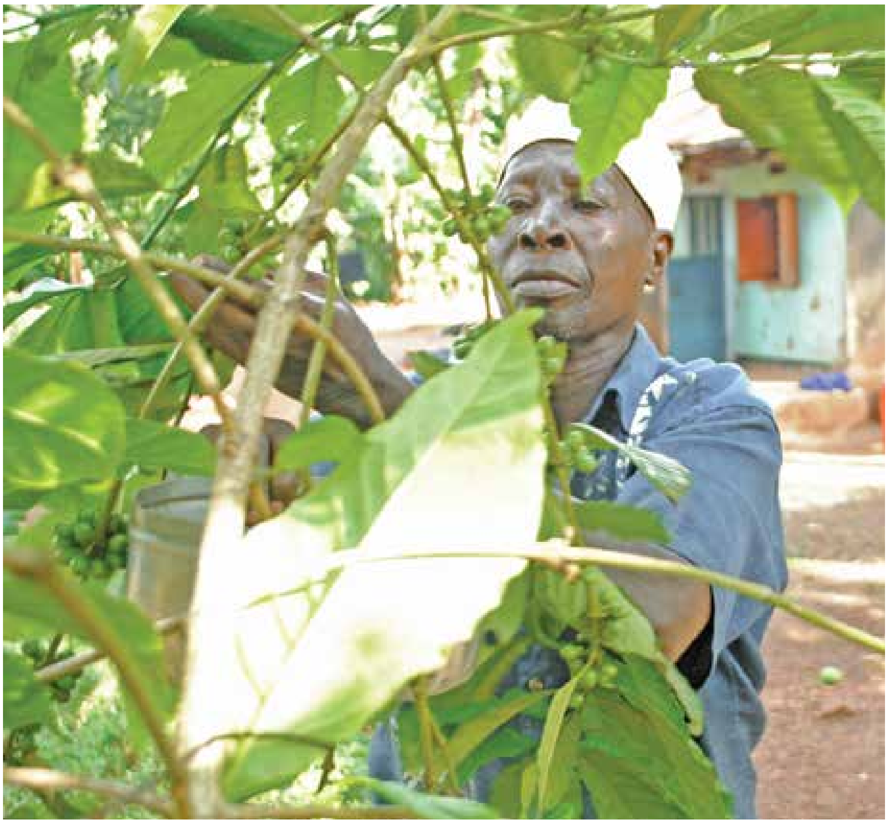
Source: Stewart and Yermo (2009)

2.3 Designing and implementing a pension system that can maximize value for Ugandans

Uganda has started on a number of reforms to the pension sector to improve the regulatory environment. As summarized in Table 5, each of the suggested reforms are intended to facilitate improvements in terms of at least one of the five key aspects of an efficient pension system defined earlier.

Table 5: Pension reform to move Uganda towards old-age security

Principle	Reform to be effected	Instrument
Coverage	Expand social assistance to poor and vulnerable households	Draft National Social Protection Policy Liberalization Bill (Retirement Benefits Sector Bill)
Adequacy	Pension schemes for informal sector workers launched	Liberalization Bill (Retirement Benefits Sector Bill)
Sustainability	Reform of Public Sector Pension Scheme	PSPF Reform Plans
Security	Pension Regulator established	Uganda Retirement Benefits Regulatory Authority (URBRA) Act of 2011 PSPF Reform Plans
Efficiency	Reform of monopoly social security funds	Liberalization Bill



An effective pension system should consist of five key characteristics: coverage; adequacy; sustainability; security; and efficiency.

Without pension, this former civil servant resorts to coffee farming in Zirobwe, Luwero, Central region (Great Lakes Film Production Ltd, 2014)

2.3.1 Key aspects of Uganda's proposed reform to the pension system

The Government has started to reform the pension sector with main objective of protecting the savings of workers. Goals include ensuring these savings are invested well to give a good return to savers whilst minimizing against potential risk, ensuring that those who save get their benefits in the form of pension, lump sum or other forms of benefit, improving the administration of the sector, and to provide a policy and legal framework to grow retirement savings in the economy[28].

The first step was to create the regulator for the pension sector. The Uganda Retirement Benefits Regulatory Authority (URBRA) Act of 2011 established a pension sector regulator to provide monitoring and oversight. The authority will license all schemes, including the NSSF, to ensure that these schemes meet international standards for investment and risk management. Investment Regulations, specifying the instruments into which the funds may invest (including within the East Africa Community), have already been issued. All schemes now have to be established as trusts, with Boards of Trustees, including member representatives, responsible for investment decisions and assets separated from sponsor funds (so that employers cannot access or misappropriate members' savings). URBRA will play a key role in building confidence in the pension system, a vital prerequisite if long-term savings systems are to flourish. Without proper oversight of the financial sector, Ugandans will not be prepared to trust either public or private sector institutions with their money.

The proposed Liberalization Bill, currently before Parliament, seeks to create a more competitive environment for the management of social security contributions in an attempt to improve the rate of return for investors. The Bill proposes that employees can choose to invest at least part of their contributions with a licensed retirement benefits scheme other than the NSSF. The NSSF will not disappear, and workers can choose to leave their money with the fund. However, it is argued that creating a more competitive environment and introducing professional fund management into the system will improve levels of transparency and accountability induce innovation in collection methods, products and new investments, and ultimately lead to higher returns on existing pension assets. URBRA will regulate the financial market for private pensions. In addition, the Bill proposes to extend coverage to all workers in the formal sector, rather than merely those in firms employing five or more workers. This will extend coverage to a potential 2.5 million workers, or 17 percent of the current labor force, although enforcing compliance rates amongst small firms will be difficult. Employees and employers in the informal sector or self-employed workers can also choose to make voluntary contributions into a licensed retirement benefits scheme. The Bill also proposes replacing the current lump sum payments made by NSSF, with a system that pays annual installments until the beneficiary dies.

The Government is furthermore proposing to reform the public sector pension scheme by turning it into an independently-managed pension fund with contributions from both the Government employer and civil service employees. The planned reform of the Public Service Pension Fund has two main goals. On one hand, a parametric reform of the existing pension benefits is intended to reduce the scheme's generosity to ensure its future fiscal sustainability. The scheme will be contributory, but with a formula that guarantees the level of pension based on number of years of service, level of pay and other parameters. In addition, the Fund's establishment as a funded, independent scheme, with a trustee board and oversight by URBRA, will improve transparency and discipline into the governance of the scheme. Administrative improvements to support this reform and to address governance problems include the change from the Pension Information Management System (PIMS) to the Integrated Personnel and Payroll System (IPPS) designed to track employees from recruitment to retirement. There are also plans to clean up the payroll and pension records through decentralization as a means of tackling the issue of the enrolment of ghost pensioners. The reforms should ensure that pensioners who currently struggle to get their pensions or even die without being paid actually get their benefits.

Finally, the Government also has a long-term vision for the pension sector. Although the current focus of the Government's pension reforms is to place existing schemes on a sounder financial footing and to improve their governance, the longer-term goal is to extend pension coverage throughout the Ugandan society. At present, an extension of the NSSF to cover all formal sector workers has been proposed. However, this will still leave a significant

[28] Source: Ministry of Finance, Planning and Economic Development, URBRA

proportion of the country's workers without cover, since the vast majority of Ugandans work in the informal sector. Extending coverage to this group will require the development of schemes specifically designed to meet the needs of employees at the country's numerous small informal sector firms and of agricultural workers.

The Government has been piloting a social pension scheme in 17 districts to test the provision of support for vulnerable elderly people not covered by social security. The goal of providing support to the elderly people is recognized in the Government's Draft National Social Protection Policy Framework. Details regarding the possible extension of the scheme, its coverage and the possible targeting of the benefit through means testing or other mechanisms are still being studied.

2.3.2 Addressing reform challenges

The Government will face a number of challenges in its endeavors to implement reforms to the pension system. Such endeavors almost always involve the implementation of measures that may be deeply unpopular with parts of the population and with vested interests. Therefore, it is likely that these measures will be met with resistance. In addition, it will be challenging to implement reforms due to their breadth and to the limited capacity of the institutions involved. Finally, the measures may trigger economic and public financial management issues due to the Government having to raise finance to cover the transition costs of transforming the Public Service Pension Fund into a funded system.

i. Governance amidst high fraud and corruption

As with any reforms in Uganda, reforms to the pension system may entail substantial governance-related risks, both on a macro level and more specifically for the pension sector. Petty and high-level corruption is prevalent, as indicated by Uganda's low ranking in the Transparency International's Corruption Perception Index and by the Global Integrity Report's opinion that corruption is the biggest obstacle to doing business in Uganda.

With regard to the pension sector, the transformation of the Public Sector Pension Scheme into a separate, funded pension fund should facilitate the achievement of higher levels of transparency. However, it is important that measures to improve the quality of governance, with these measures including the appointment of a trustee board, the requirement to use external asset managers and custodians and oversight from the regulator, URBRA, are fully and appropriately implemented, rather than being merely a formal requirement.

The new Integrated Payroll and Personnel System, which is designed to improve the quality of governance of the public service pension scheme, continues to face implementation problems, including the quality of the data transferred and the dysfunctional state of a number of internal checks. At the same time, the decentralization of payroll and pension systems continues to be highly politicized. Unless robust data, collection and payment systems are established, the governance challenges, which the reforms are meant to fix, will remain unaddressed, with the reformed system continuing to be vulnerable to future abuse.

Making NSSF comply with new regulations and prevent governance problems transferring the private sector are important challenges. Governance of the NSSF should be improved through the application of fit and proper standards to the trustee board and through the use of professional, external fund management and custodian arrangements. Creating a more competitive environment through the involvement of the private sector in the management of the NSSF and mandatory social security contributions is intended to improve efficiency by facilitating greater transparency and higher levels of professionalism. Under the proposed reforms, all pension funds need to be licensed, regulated and supervised. International experience (including from regions such as Latin America, which has suffered from governance problems in the past) has shown that, individual incidents aside, the private management of pension funds has resulted in higher levels of protection to pension fund members against loss of assets. However, in a context of weak financial institutions and inadequate supervision, the change could simply shift the governance risk from the public to the private financial sector. This risk can only be managed through proper regulation and supervision.

The overall challenge in regulation and supervision of the sector lies in the strength and effectiveness of URBRA. URBRA has responsibility for the oversight of all pension funds in Uganda, including the NSSF and voluntary occupation funds. Its mandate is: To enforce the key elements of the existing regulatory framework; to separate functions of various entities; to ensure limits for investments are adhered to; to ensure that funds meet the set performance benchmarks; and to ensure that the assets are valued appropriately. URBRA is a new institution, which will be required to quickly develop the capacities to fulfill its supervisory role and to formulate a vision for the pension market in the post-liberalization period. A strong, independent regulator will play a vital role in making the reformed, competitive pension system work effectively and in building a strong basis for the extension of pension coverage. In this regard, learning from the experiences of newly established authorities that have successfully tackled the challenges related to difficult reforms to the pension systems can be derived from the experiences of a number of other countries, including Chile and Kenya.

ii. Increased costs, limited capital markets and low capacity may constrain benefits

There are concerns that private sector competition will simply mean higher costs within the pension sector, due to marketing battles to secure mandatory contributions. Failure to control costs has been a persistent problem in the establishment and management of privately managed pension systems around the world. Marketing costs have stayed persistently high, and individuals have proven insensitive to pricing issues, arguably only reacting to short-term performance measures. How Ugandans, with limited financial experience, are meant to develop the capacities to make informed choices regarding their pension funds is not clear. These problems have been tackled in a number of ways in different countries, with measures ranging from cost caps to low cost default funds. URBRA will have to learn from these experiences.

Pension fund administration and investment management both benefit from economies of scale. Therefore, costs could actually rise if the NSSF centralized system is replaced by a plethora of smaller schemes. This is important, as the effect of seemingly small increases in annual charges have an accumulated effect over a number of years. For example, it has been estimated that for every one percent increase in annual charges, if applied over the full period for which a worker contributes to a pension scheme, the level of benefits is reduced by approximately 20 percent. A factor exacerbating the challenges created by the implementation of reforms is that no clear picture has emerged regarding what the post-liberalization pension market will or should look like. In order to create clarity, questions related to whether or not contribution collection should be centralized; how many fund managers a relatively small market can support; and the potential role for the NSSF in the new system all need to be addressed.

The level of development of the capital market also remains low and this may create challenges to the achievement of some efficiency objectives. The NSSF portfolio is highly concentrated and dominates both the local equity and Government bond markets. Without both the development of a broader range of local investment opportunities and the possibility for increased geographical diversification, it will not be possible to greatly increase the returns generated by the NSSF or private sector players. Also, concentration and related governance risks will remain. Similar issues related to the inability to achieve portfolio diversification and a failure of domestic capital markets to develop have been factors driving the reversal of pension reforms seen in recent years in Eastern Europe. Plans to develop the financial and capital markets need to be strengthened if pension assets are to contribute to long-term financing.

Key stakeholders already appreciate the need for a broader range of financial instruments in order to ensure that pension assets generate acceptable returns. The current management of NSSF is diversifying the portfolio of assets under their management. The management of NSSF supports the idea of allowing for the investment of assets in international markets. The management of the potential buildup of assets in the PSPF fund will also need careful consideration. Recycling these assets back into Government bonds would achieve little. Additional resources will also flow to the capital market from the contributions of formal workers who were previously not covered under the NSSF. Regulations issued by URBRA and its ability to monitor the sector will be critical to enhancing the sector's efficiency.

The main challenge to the reform of the public service pension fund is the lack of institutional capacity at the Ministry of Public Service (MoPS). Following governance issues in 2012, the management team at MoPS, together with the technical team responsible for the management of pensions, was replaced entirely. While this change may have been necessary, it places great strain on the new management team, which will need to quickly build the capacities required to manage the proposed reforms.

A unique personal identification system is an essential building block for administrative reform and will be required before pension coverage

can be substantially expanded. The recently inaugurated national identity card is expected to address this, but if not successful, the lack of a national, universal personal identification system could jeopardize the goal of further increasing coverage of the pension system.

iii. Fiscal cost of pension will increase in the short term before declining

The move from an unfunded to a funded public pension scheme involves fiscal costs. The suggested reform implies that Government will have to continue paying existing pensions accrued under the old public pension system while at the same time also making contributions into the new public pension scheme in order to fund future benefits. Many civil service schemes around the world remain unfunded (in contrast to national social security schemes) because of similar transition issues. The short-term transition costs associated with the establishment of national funded schemes were not fully appreciated or accounted for in Eastern Europe, which was one of the reasons for the recent reform reversals. The International Labor Organization (ILO) supports the continuation of pay-as-you-go pensions for these fiscal reasons, amongst others. The cost of providing pensions will increase before declining (see Box 10), but their magnitude will also be increasing the longer the reform is postponed. If the Government were to transfer all the previous pension rights, which public servants had accrued to the new fund, this would make an implicit pension debt explicit, which would also raise Government debt levels. This needs to be seen in the context of the recent deterioration of the Government's fiscal policy stance, which has threatened to erode Uganda's track record of sound macroeconomic management. Given the tight budgetary conditions, financing the transition costs of moving to a funded PSPF could be challenging. Though likely to only represent a small percentage of GDP, this could represent a significant portion of the Government's revenues, given the low rate of tax collection in the country. In the long run, the financial sustainability of the fund could be put at risk if the parametric reforms to the PSPF scheme are not sufficient to balance contributions and benefits, and if the Government fails to pay its contributions.

Box 10: Simulation of fiscal costs of reform of the public sector pension system

What is the current cost of the public sector pension system (PSPF)? The major and most pressing issue with the current structure of PSPF is its cost. Currently, the Government spends 0.4 percent of GDP on PSPF pensions (excluding military). In the future – with the same size of civil service relative to population – that indicator almost triples. The main factors contributing to the rapidly increasing cost of the scheme are demographic changes (growing system dependency rate) and the design of the scheme.

What reform? Suppose Government reformed the PSPS and established a new system for civil servants as a separate entity funded by contributions by employees (5 percent) as well Government (10 percent) as is currently being done for the private sector pension under NSSF. If in addition some of the parameters (for example the retirement age and the accrual rate) in new arrangement are revised to reduce the cost of the scheme such that the replacement rate declines from the current 87 percent to about 50 percent.

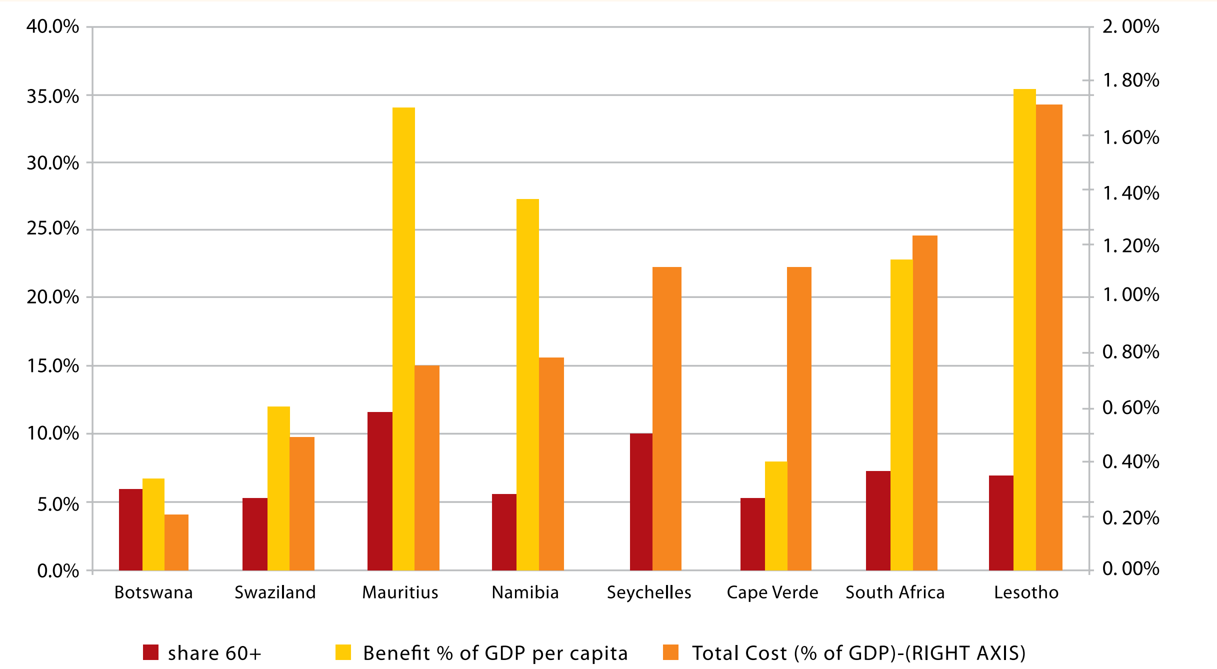
What would happen to cost of providing pensions for public servants? The cost of providing pension will increase in the short-term because of the need to pay for accrued rights while starting to pay the 10 percent contribution for the staff in the new scheme. In addition, the Government may grant a pay rise at the time the reform is introduced to compensate for public sector workers also having to make contributions into the fund. Moreover, if the Government (and not the Pension Fund) takes responsibility for the accrued pension rights, the Government would have to raise some sort of bond to compensate the new fund for taking on these liabilities, which would have fiscal implications.

By how much could costs increase? The transition cost could amount to about 0.1 percent to 0.3 percent of GDP, depending on how the different parameters of the scheme are changed. This would raise the total pension obligations for Government to increase to a peak of about 0.75 percent of GDP by 2019 (i.e. about 5 years after the reform), which is almost twice the current cost, before it starts to come down. In about 5 years, government would have reduced the cost of pensions to the 10 percent of wage bill.

Source: World Bank staff calculations

In addition, the Government will need to start planning for how to pay for social assistance for older Ugandans. While evidence from countries around the world shows that social assistance programs are affordable and can be an effective means of reducing poverty and vulnerability, a range of questions with regards to the scale, design and sequencing of interventions will have implications for the costs of such schemes in short- and longer-term (see Figure 25). Firstly, universal schemes are often more expensive than those targeting support to a sub-set of the population, including those most in need. Secondly, there may be scope to provide support to vulnerable older person under the umbrella of a social assistance program that is targeted to poor households, although public resources arguments for directing support to young people should poverty rates be higher among this group. Finally, the costs of such programs will evolve over time as the population ages and as the reforms in the pension sector take hold (or not). Extending the coverage of contributory schemes will reduce the need for Government to provide public support to vulnerable and poor older people.

Figure 25: Cost of social pensions in Africa



Universal schemes are often more expensive than those targeting support to a sub-set of the population, including those most in need.

In Jinja, touring the source of River Nile (Ann Hoel, 2009)

2.4 Conclusion

Despite Uganda's young population, there is an urgent need for pension reform. Limited social protection is leaving vulnerable elderly members of society exposed to poverty, a situation that is exacerbated by the fact that few workers save for their own retirement. This failure results in a low domestic savings rate, with under-developed capital markets acting as a brake on potential growth and development. In addition, the limited range of existing pension schemes has been poorly managed and has suffered from governance problems, which destroy the confidence in financial systems that form the basis for public trust in long-term savings schemes. Finally, Government spending on pensions provided benefits primarily to a small, relatively highly paid group of public sector workers, with this expenditure set to rise. This rising expenditure places limits on the available fiscal resources for other vitally necessary poverty alleviation and development programs.

Experience from other countries, including those in the African region, has shown that, though never easy and often controversial, the reforms required to establish efficient, equitable pension systems can be successfully implemented. The reforms that are currently being launched in Uganda are steps in the right direction. For the public sector pensions, the proposed reforms are expected to convert the pension system into a fiscally sustainable scheme, where government, the employer, and its employees contribute to the public service pension fund, proper governance and administration so that pensioners access their benefits appropriately and in a timely manner. The proposed change in some parameters of the scheme will also make it more affordable by government. For the private sector pensions, introducing competition and professional fund management is expected to improve levels of transparency and accountability, induce innovation in collection methods, products, style of investment and ultimately returns on the pension assets. The new regulator should build sufficient capacity to ensure the market operates efficiently to realize these anticipated benefits.

If the proposed reforms are successful, Uganda can expect to have a better retirement benefits process for its citizenry, which is more fiscally sustainable and contributing to the development of financial system and generation of higher savings, both of which can support higher investment.

However, it is a long path to the achievement of the final goals of these reforms. A high level of sustained Government commitment will be necessary to address the serious challenges, especially in relation to governance, that are bound to arise in order to see the reforms through to a successful conclusion.

STATISTICAL ANNEXES

Table A 1: Macroeconomic Indicators

	Unit measure	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Population	Millions	26.7	27.6	28.6	29.6	30.7	31.8	32.9	35.4
GDP	USD	9,958	11,903	14,440	15,596	15,246	14,791	19,620	21,448
Per capita income	USD	372	31	506	527	497	465	596	606
GDP growth	%	10.8	8.4	8.7	7.2	5.9	6.7	3.4	5.8
Gross Domestic Savings	as % of GDP	13.2	16.0	15.9	12.2	12.2	11.3	10.1	14.3
Gross Investments	as % of GDP	21.2	23.6	23.0	23.5	24.2	24.7	24.6	24.5
Inflation (period average)	%	6.6	6.8	7.3	14.2	9.4	6.5	24.6	6.6
Exchange Rate (period average)	UGX/USD	1825	1778	1696	1905	2030	2323	2557	2591
External Sector									
Exports - Goods and Services	Million USD	1,041.2	1,473.8	2,073.0	2,216.4	2,317.3	2,297.8	2,660.4	2,982.5
Imports - Goods and Services	Million USD	-1,969.0	-2,495.2	-3,510.4	-4,062.2	-4,116.8	-4,671.1	-5,264.3	-5,044
Current Account Balance	Million USD	-314.5	-342.0	-902.7	-1,258.6	-1,435.0	-1,686.3	-2,070.5	-2,134
Balance of Payments (overall balance)	Million USD	198.23	703.9	563.0	-45.70	210.9	-581.2	731.4	386
Foreign Reserves	Million USD	1408.3	2090.8	2684.4	2442.0	2384.7	2044.0	2346.1	2,912
External Debt	Million USD	4464.4	1466.8	1687.0	2046.4	2343.4	2904.9	3972.3	4,824
Foreign Direct Investment	Million USD	512.04	718.28	760.6	785.22	692.72	755.07	1065.3	925
Tourism Earnings	'000 USD		449	590	564	662	805	1,062	1,198
Monetary Sector									
Average Deposit Rate	%	2.6	2.2	2.2	2.1	2.0	2.6	3.3	3.0
Average Lending Rate	%	16.1	16.9	18.2	18.8	18.2	19.2	24.6	24.8
Growth in Money Supply	%	16.4	17.4	31.1	25.0	31.7	25.9	15.7	6.6
Government Finance									
Total Domestic Revenue	% of GDP	12.5	12.6	12.8	12.5	12.2	13.3	13.3	13.2
Tax Revenue	% of GDP	11.8	11.9	12.3	11.8	11.7	12.7	12.3	12.9
Non Tax Revenue	% of GDP	0.7	0.7	0.5	0.7	0.6	0.6	0.2	0.3
Total Expenditure	% of GDP	18.6	18.6	17.9	17.3	19.6	22.8	18.6	18.9
Recurrent Expenditure	% of GDP	12.3	11.5	11.8	10.9	12.3	15.3	10.9	10.5
Development Expenditure	% of GDP	6.0	6.1	5.6	5.6	6.6	7.1	7.2	7.6
Grants	% of GDP	5.4	4.5	2.7	2.6	2.5	2.3	2.3	1.7
Fiscal Balance (overall)	% of GDP	-0.8	-1.5	-2.4	-2.2	-4.9	-4.3	-3.0	-4.0

Source: Bank of Uganda; Uganda Bureau of Statistics; Ministry of Finance,Planning and Economic Development

Table A 2: Growth and Structure of Uganda's Economy

Economic Activity	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Real GDP Growth Rates (%)	**10.8**	**8.4**	**8.7**	**7.2**	**5.9**	**6.7**	**3.4**	**5.8**
Agriculture	0.5	0.1	1.3	2.9	2.4	0.7	2.2	1.5
Industry	14.7	9.6	8.8	5.8	6.5	7.9	2.4	6.8
o/w manufacturing	7.3	5.6	7.3	10.0	6.6	8.0	-1.0	5.7
o/w construction	23.2	13.2	10.5	3.7	5.9	7.8	3.2	7.5
Services	12.2	8.0	9.7	8.8	8.2	8.4	3.3	6.5
GDP at market prices (%change)	13.4	16.7	15.5	22.9	16.0	11.9	28.4	10.8
Shares of GDP (%) 2002 Prices								
Agriculture	24.1	22.3	21.4	23.1	23.6	22.7	24.4	13.0
Industry	22.8	25.2	25.8	24.7	24.9	25.3	26.4	25.2
o/w manufacturing	7.1	7.1	7.3	7.9	7.7	8.6	8.3	6.7
o/w construction	11.7	13.1	13.6	12.3	12.7	13.0	13.0	15.2
Services	47.2	47.0	46.9	46.4	45.5	46.2	44.3	53.0
FISM and net taxes	5.9	5.6	6.0	5.7	6.0	5.8	4.9	8.8
Contribution to Real GDP Growth (%)								
Agriculture	0.1	0.0	0.2	0.5	0.4	0.1	0.4	0.2
Industry	3.5	2.4	2.2	1.5	1.6	2.0	0.3	1.7
o/w manufacturing	0.5	0.4	0.5	0.7	0.5	0.5	-0.1	0.4
o/w construction	3.0	1.9	1.6	0.6	0.9	1.2	0.3	1.1
Services	6.0	4.0	4.8	4.4	4.2	4.4	1.6	3.5
Shares of GDP by type of expenditure (%)								
Final Consumption Expenditure	91.9	89.7	84.7	88.2	89.5	93.5	92.3	
Households	77.8	76.9	73.5	78.1	79.8	83.6	83.6	
Government	14.1	12.7	11.2	10.1	9.7	9.8	8.7	
Gross Capital Formation	21.2	23.7	23.0	22.0	23.5	25.0	24.4	
Gross fixed capital formation	21.0	23.4	22.7	21.7	23.2	24.8	24.1	
Charges in inventories	0.2	0.2	0.2	0.3	0.2	0.2	0.3	
Net exports	-13.1	-13.3	-7.7	-10.1	-12.9	-18.5	-16.7	
Gross domestic saving (% of GDP)	13.2	16.0	15.9	12.2	12.2	11.3	10.2	13.3
Public	-1.2	-0.8	-0.1	0.9	-0.4	-5.3	-0.3	1.5
Private	14.3	16.8	16.0	11.3	12.6	16.6	10.5	11.9

Source: Uganda Bureau of Statistics

Table A 3: Quarterly Growth Rates FY 2010/11 - 2013/14

Year	2010/11				2011/12				2012/13				2013/14	
Quarter	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP at market prices	1.6	5.3	-0.3	0.5	0.5	-0.6	2.7	1.7	1.6	0.6	1.4	2.1	1.0	2.3
GDP at basic prices	0.8	5.7	0.1	0.2	0.4	-0.5	2.2	2.2	1.9	0.4	0.8	2.2	0.9	2.9
Agric., forestry and fishing	-8.8	14.5	-3.5	-5.7	5.8	-1.9	-1.6	1.0	2.0	-2.7	3.7	0.9	-3.4	0.2
Cash crops	-3.8	10.4	-8.2	-3.4	14.5	-1.6	-2.3	6.4	-4.5	-2.3	14.8	3.6	-3.4	-4.2
Food crops	-15.3	25.9	-6.2	-10.0	7.9	-3.6	-2.1	0.2	4.0	-5.1	3.7	0.5	-6.5	0.7
Livestock	1.1	0.6	0.5	0.6	1.2	0.4	0.5	0.6	1.0	0.5	0.6	0.7	0.9	0.6
Forestry	0.7	0.8	0.8	0.9	0.9	0.8	0.7	0.6	0.6	0.7	0.8	0.9	1.1	1.1
Fishing	-1.4	-1.3	6.7	-0.3	0.4	0.5	-4.8	1.2	1.7	1.3	1.3	0.6	0.5	0.1
Industry	4.8	4.6	-0.4	1.0	-2.8	1.3	3.8	3.6	0.8	-0.1	0.2	4.2	2.9	4.8
Mining and quarrying	-2.0	56.0	-3.3	8.7	-15.3	9.5	-7.9	20.8	-11.1	-5.6	-4.7	23.0	15.8	36.1
Manufacturing	0.8	15.1	-1.8	1.2	-5.3	-2.4	4.2	6.6	-1.2	-1.4	-1.8	10.3	1.9	8.5
Formal	3.2	8.5	-0.5	0.2	-4.1	-6.5	8.3	4.0	0.7	-1.5	0.0	7.7	-3.7	1.4
Informal	-7.2	39.5	-5.5	4.0	-9.0	10.0	-6.4	14.4	-6.3	-1.4	-7.0	18.6	17.6	25.1
Electricity supply	0.5	4.2	2.0	2.7	-1.0	1.5	4.9	2.4	3.6	1.5	1.1	2.7	0.5	-0.7
Water supply	1.2	0.5	1.4	2.3	0.6	-0.3	1.5	1.9	1.8	-0.5	2.1	0.3	2.9	-0.2
Construction	7.5	-0.2	0.0	0.4	-1.7	3.0	4.1	2.1	1.7	0.5	0.9	1.7	3.2	3.1
Services	2.4	4.2	1.2	1.4	0.2	-1.1	2.3	1.7	2.6	1.5	0.2	1.5	1.2	2.7
Wholesale and retail trade	-5.3	14.0	-1.6	-4.4	4.5	-2.2	1.5	4.0	-1.5	-1.5	-1.5	7.3	0.5	7.5
Hotels and restaurants	-4.0	-0.8	1.0	5.0	7.4	5.6	3.0	0.5	-0.1	-0.3	4.0	-0.9	0.2	2.5
Transport & communications	4.9	-2.4	9.4	2.0	5.3	-3.3	6.3	0.6	8.1	5.6	-3.8	0.5	1.4	0.6
Road, rail & water transport	-3.0	-23.2	55.2	-14.5	4.5	-11.8	18.5	-11.9	3.3	12.4	-10.0	3.7	0.3	0.8
Air transport & support svcs	5.2	1.8	-7.7	6.4	3.5	5.2	5.3	2.5	1.0	-0.5	4.0	4.3	-1.9	-0.2
Posts & telecommunication	12.9	15.4	-15.4	19.3	6.1	2.2	-1.6	10.1	12.0	2.2	-0.6	-1.7	2.4	0.6
Financial services	8.9	10.7	-2.4	7.1	-12.2	-3.0	-4.3	2.4	1.6	6.5	4.0	-8.0	1.7	2.0
Real estate activities	6.2	2.4	1.8	1.0	1.3	0.3	2.9	1.1	1.4	1.4	1.2	0.9	0.7	1.2
Other business services	4.6	0.4	-2.5	-1.5	9.2	-0.7	-6.0	-0.1	11.2	-3.3	-0.5	-1.2	-2.5	3.0
Public administration	8.0	-0.3	-5.9	-7.5	0.6	-5.4	-8.0	1.1	16.5	-0.2	1.8	-0.4	-2.7	2.5
Education	10.0	0.7	4.9	8.4	-17.8	2.8	7.9	3.1	-1.3	2.7	0.1	1.5	7.9	-2.1
Health and social work	2.7	1.3	4.0	9.9	-12.8	5.6	0.7	-1.5	-0.6	-5.8	-3.5	11.6	-4.8	-3.1
Other personal & comm. svcs	1.1	3.9	-2.2	13.3	5.7	-6.0	5.8	-1.5	0.2	5.8	10.4	-2.3	1.5	5.5
FISIM	20.4	11.7	-2.9	-0.3	-8.8	-3.5	-2.2	-0.6	5.2	5.1	-3.7	0.1	4.8	3.8
Net taxes on products & imports	8.8	2.0	-3.5	2.9	1.6	-0.9	6.8	-2.4	-1.5	2.2	6.9	1.0	1.8	-2.9

Source: Uganda Bureau of Statistics

Table A 4: Fiscal Framework (as percent of GDP)

as % of GDP	2005/6		2006/7		2007/8		2008/9		2009/10		2010/11		2011/12		2012/13	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Outturn	Budget	Outturn
Total revenue and grants	**19.7**	**17.8**	**17.4**	**17.1**	**17.1**	**15.5**	**17.2**	**15.1**	**16.6**	**14.7**	**16.0**	**18.4**	**15.6**	**15.5**	**15.9**	**14.9**
Revenue	13.1	12.5	12.1	12.6	13.0	12.8	13.1	12.5	13.0	12.2	13.1	16.2	12.6	13.2	13.6	13.2
Tax*	12.5	11.8	11.9	11.9	12.6	12.3	12.8	11.8	12.8	11.7	12.9	12.7	12.4	11.9	13.3	12.6
Nontax	0.6	0.7	0.2	0.7	0.5	0.5	0.3	0.7	0.2	0.6	0.2	0.6	0.2	0.3	0.3	0.6
Grants	6.6	5.4	5.3	4.5	4.1	2.7	4.1	2.6	3.6	2.5	2.9	2.3	2.9	2.3	2.3	1.7
Budget support	3.9	4.1	2.6	3.7	2.1	1.9	1.6	1.8	1.7	1.3	1.6	1.3	1.3	1.2	0.9	0.4
Project grants	2.6	1.3	2.6	0.9	2.0	0.8	2.5	0.9	1.9	1.1	1.3	1.0	1.7	1.1	1.4	1.3
Total Expenditure	**21.0**	**18.6**	**20.1**	**18.6**	**19.3**	**17.9**	**20.4**	**17.3**	**20.3**	**19.6**	**19.1**	**22.8**	**19.8**	**18.5**	**20.0**	**18.9**
Recurrent	11.8	12.3	11.2	11.5	11.1	11.8	10.5	10.9	10.3	12.3	11.7	15.3	10.0	11.1	10.2	10.5
Development	8.4	6.0	8.2	6.1	7.8	5.6	9.0	5.6	9.9	6.6	7.1	7.1	9.4	6.9	9.7	7.6
Overall balance																
Including grants	-1.9	-0.8	-2.7	-1.5	-2.2	-2.4	-3.1	-2.2	-3.7	-4.9	-3.1	-4.8	-4.2	-3.0	-4.1	-4.1
Excluding grants	-8.5	-6.1	-8.0	-6.0	-6.3	-5.1	-7.2	-4.8	-7.3	-7.3	-6.0	-7.1	-7.2	-5.3	-6.4	-5.8
Financing	**1.9**	**0.6**	**2.7**	**1.7**	**2.2**	**2.0**	**3.1**	**0.3**	**3.7**	**4.4**	**3.1**	**4.8**	**4.2**	**3.0**	**4.1**	**4.1**
External financing (net)	2.7	1.7	2.5	3.3	3.1	2.5	2.1	1.7	3.0	2.2	1.9	1.4	2.4	2.3	2.3	2.6
o/w Budget support	0.6	0.4	1.2	1.9	0.8	0.9	0.6	0.8	0.7	0.7	0.1	0.6	0.7	0.6	0.5	0.6
Domestic financing (net)	-0.8	-1.1	0.2	-1.7	-0.9	-0.5	1.0	-1.4	0.6	2.1	1.2	3.4	1.9	0.7	1.8	1.5

*Excludes Taxes on oil transactions

Source: Ministry Finance, Planning and Economic Development

Table A 5:Balance of Payments (percent of GDP unless otherwise stated)

Variable	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Current Account (incl transfers)	-3.2	-2.4	-6.0	-7.8	-9.9	-11.8	-10.5	-7.4
Exports of goods	10.5	-8.6	-10.0	-11.8	-11.8	-16.0	-13.4	-9.9
Imports of goods	-19.8	12.4	14.4	14.2	15.2	15.4	13.6	14.0
Services (net)	-1.8	-21.0	-24.3	-26.0	-26.9	-31.4	-27.0	-23.9
Trade balance	-9.3	-1.8	-3.0	-2.6	-3.2	-4.2	-2.0	-1.7
Income (net)	-2.5	-1.9	-1.8	-2.0	-2.2	-2.3	-2.5	-3.2
Current transfers (net)	10.4	9.9	8.8	8.6	7.3	10.7	7.3	7.3
Capital and Financial Account	8.8	8.3	8.0	7.5	9.9	5.4	11.2	9.2
Capital account*	1.3	28.8	0.0	0.0	0.0	0.0	0.1	0.2
Financial account	7.6	-20.5	8.0	7.5	9.9	5.4	11.1	9.1
o/w direct investment	5.1	6.0	5.3	5.0	4.5	4.8	6.5	5.9
Overall Balance	**2.0**	**5.9**	**3.9**	**-0.5**	**1.5**	**-4.1**	**3.8**	**1.6**
Gross International Reserves (million USD)	1,408.3	1606.9	2063.6	2704.4	2442.9	2044	2644	2912
Gross international reserves in months of imports	5.1	5.8	5.4	5.9	5.9	3.2	4.2	4.4

Source: Bank of Uganda

Table A 6: Monthly Imports of Goods, 2012-2013 (in US$ Millions)

	2013									2014		
Nature of Imports	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Formal Private Sector Imports:												
Animal & Animal Products	1.2	1.8	1.6	1.5	2.1	1.8	2.4	1.7	2.1	1.98	2.06	1.92
Veg Pdts, Animal, Fats & Oil	36.6	33.1	43.9	24.4	27.1	28.4	33.2	33.8	33.5	31.64	41.62	39.70
Prep Foodstuff, Beverages & Tobacco	20.7	23.3	21.1	21.5	19.7	14.6	20.4	20.5	23.2	21.98	18.62	24.81
Mineral Products (excl oil products)	9.1	9.9	9.9	11.9	11.9	12.5	14.4	12.4	11.5	28.09	11.62	12.72
Petroleum (Oil) Products	78.8	81.5	85.4	85.0	82.8	83.3	83.7	84.5	77.2	76.90	112.60	94.27
Chemical & Related Products	33.4	45.6	33.2	65.7	39.4	40.2	38.7	32.9	37.9	34.39	37.46	34.82
Plastics, Rubber, & Related Products	20.8	23.3	24.3	19.5	19.4	18.0	19.8	22.5	21.2	22.04	16.93	20.92
Wood & Wood Products	7.4	12.1	8.9	10.4	10.1	9.4	9.6	9.3	11.6	8.82	14.13	8.40
Textile & Textile Products	8.7	12.6	11.4	12.7	11.4	12.5	12.6	13.7	16.7	13.76	14.60	12.84
Miscellaneous Manufactured Articles	30.6	22.5	20.2	18.2	19.6	19.5	17.9	20.1	20.1	20.47	15.50	17.79
Base Metals & their Products	25.3	29.7	34.8	33.9	23.3	24.9	23.7	28.4	26.2	27.26	26.94	26.08
Machinery Equip, Vehicles & Accessories	79.3	107.8	93.7	111.5	109.8	95.7	93.3	87.7	88.1	96.46	94.56	141.37
Arms & Ammunitions & Accessories	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.00	0.00	0.00
Electricity	0.6	0.8	0.8	0.7	0.7	0.8	0.9	0.9	0.9	0.78	0.85	0.36
Subtotal (formal private sector imports)	*352.5*	*404.1*	*389.4*	*416.7*	*377.3*	*361.7*	*370.7*	*368.4*	370.2	384.57	407.50	435.99
Other Estimated Private Sector Imports	4.2	4.3	4.1	4.2	4.2	5.2	4.5	4.6	5.0	4.07	3.90	4.07
Government Imports	47.3	26.0	50.3	14.7	48.5	38.9	28.7	37.0	45.0	7.40	37.07	21.97
Total Imports (fob)	404.1	434.4	443.8	435.6	430.0	405.8	403.9	410.1	420.3	396.04	448.47	462.03
Total Imports (cif)	495.2	532.6	545.1	534.8	528.3	495.8	494.8	500.1	513.8	484.46	551.17	564.95
o/w freight	*87.2*	*94.0*	*96.9*	*95.0*	*94.1*	86.2	87.0	86.2	89.5	84.68	98.36	98.57
o/w insurance	*3.9*	*4.2*	*4.3*	*4.2*	*4.2*	3.8	3.8	3.8	4.0	3.74	4.34	4.35
freight as % of total imports cif	*17.62*	*17.66*	*17.78*	*17.76*	*17.82*	*17.39*	*17.59*	*17.24*	17.42	*17.48*	*17.85*	17.45
insurance as % of total imports cif	*0.78*	*0.78*	*0.79*	*0.78*	*0.79*	*0.77*	*0.78*	*0.76*	0.77	*0.77*	*0.079*	0.77

Source: Bank of Uganda

Table A 7: Monthly Exports of Goods, 2012-2013 (in US$ Millions)

	2013									2014		
Nature of Exports	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**
Formal Exports:	194.6	226.1	214.8	202.1	191.3	185.1	189.0	190.0	180.1			
Manufactured/Semi processed goods	47.4	46.2	46.7	50.7	50.2	49.0	51.4	49.8	46.7	42.95	47.85	46.65
Base Metals & Products	11.3	11.9	11.7	14.0	12.1	11.7	12.1	11.3	9.5	8.12	10.18	10.77
Sugar	10.2	6.3	5.5	5.2	7.0	5.9	6.3	6.6	6.6	4.32	6.27	6.06
Fish & its products	5.7	3.0	8.1	8.3	7.6	7.6	8.9	9.4	8.4	9.10	8.12	7.55
Cement	8.1	9.3	9.0	9.2	9.4	9.4	8.4	6.7	8.1	6.18	7.02	6.83
Edible Fats and Oils	0.7	4.0	3.3	3.0	3.4	3.5	3.5	4.0	4.3	5.53	5.17	4.63
Soap	2.3	3.1	2.4	2.6	2.5	2.9	2.4	2.3	2.7	3.28	3.02	3.39
Plastic Products	2.9	3.3	2.0	3.6	2.7	2.8	4.1	3.2	2.5	2.86	3.40	2.85
Beer	2.4	2.0	1.6	1.7	2.0	1.9	1.8	2.1	1.9	0.63	1.83	1.60
Water	2.1	1.9	2.1	2.2	2.6	1.9	2.4	3.1	1.6	1.89	1.83	1.72
Baker's wares	1.8	1.5	1.1	0.9	0.9	1.5	1.4	1.0	1.1	1.04	1.02	1.25
Traditional exports	75.4	86.3	78.2	76.0	72.4	65.6	68.8	71.2	68.5	91.71	81.54	91.83
Coffee	30.5	48.3	42.8	45.1	35.9	25.0	22.7	26.7	25.5	38.88	35.53	38.87
Cotton	6.5	5.0	2.3	1.2	0.2	0.1	1.2	0.0	0.1	1.78	2.38	5.58
Tea	7.9	9.3	7.2	6.4	4.0	5.6	8.6	7.9	7.7	7.73	4.63	4.30
Tobacco	15.0	5.8	2.0	3.0	7.2	13.6	18.7	16.3	12.3	7.81	4.91	6.86
Maize	3.1	4.8	3.3	2.7	7.9	5.5	2.9	1.3	0.6	1.50	2.38	2.10
Flowers	1.6	3.7	6.2	5.1	4.9	4.7	4.4	4.0	4.0	2.88	1.68	4.48
Hides & skins	0.9	1.0	3.3	6.3	6.0	5.9	6.0	6.0	5.1	8.14	6.30	7.59
Cocoa Beans	5.0	3.3	6.0	1.9	2.6	2.6	2.6	4.1	10.3	7.61	8.99	7.90
Simsim	3.5	4.3	1.7	0.5	1.9	1.2	0.0	0.1	0.4	12.58	11.80	8.30
Beans	0.4	0.4	2.5	2.8	0.6	0.5	0.8	3.4	1.5	1.64	1.07	4.83
Fruits & Vegetables	1.2	0.4	1.0	0.9	1.2	0.9	0.9	1.4	1.0	1.14	1.87	1.01
Minerals	1.8	1.1	0.9	1.2	0.5	1.1	0.6	0.5	0.0	0.00	0.00	0.00
Cobalt	1.1	1.1	0.5	1.1	0.5	1.1	0.6	0.5	0.0	0.00	0.00	0.00
Gold	0.7	0.0	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.00	0.00	0.00
Other exports	70.0	92.5	88.9	74.2	68.1	69.4	68.2	68.4	64.9	65.06	64.15	65.65
Cellular Phones	4.5	5.3	6.4	2.0	4.1	4.4	1.5	1.4	2.0	0.73	0.22	1.05
Crude oil	5.9	4.3	4.2	3.9	4.4	4.0	4.5	3.5	2.4	4.12	4.27	4.36
Rice	2.9	3.7	5.0	2.5	2.7	3.5	3.3	3.2	2.8	2.28	1.71	1.97
Electricity	1.3	1.5	1.4	1.5	1.7	1.4	1.4	1.4	1.3	1.40	1.20	3.08
Oil re-exports	11.0	12.0	11.2	11.7	11.6	10.7	11.5	11.9	14.2	13.31	10.89	11.97
Other items	44.3	65.7	60.7	52.7	43.7	45.3	46.0	47.0	42.2	43.20	45.86	43.23
Informal Exports (Cross Border Trade):	36.8	39.1	32.0	33.5	33.8	36.2	35.4	36.0	36.9	30.16	25.91	30.16
Industrial products	24.0	24.6	17.8	19.7	19.6	23.5	22.4	23.4	22.2	17.82	14.94	17.82
Maize	2.7	2.3	2.6	2.5	2.5	2.4	2.2	2.1	2.2	1.91	2.53	1.91
Fish	3.2	3.9	3.8	3.6	3.8	1.7	2.6	2.3	1.9	2.20	2.00	2.20
Beans	0.7	1.1	2.2	1.3	1.5	1.3	1.4	1.4	1.8	2.03	1.06	2.03

	2013									2014		
Nature of Exports	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**
Other grains	0.7	0.6	0.5	0.6	0.6	0.3	0.4	0.3	0.3	0.32	0.32	0.32
Bananas	0.4	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.37	0.37	0.37
Other agricultural commodities	4.7	5.6	4.5	4.9	5.0	6.5	5.7	6.0	6.2	5.18	4.49	5.18
Sugar	0.4	0.3	0.2	0.3	0.2	0.0	0.1	0.1	0.0	0.17	0.10	0.17
Other products	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.8	0.16	0.10	0.16
Total Exports	231.3	265.1	246.8	235.6	225.1	221.2	224.3	226.0	217.0	231.03	225.74	237.39

Source: Bank of Uganda

Table A 8: Inflation Rates

Percentage Changes	**2007/8**	**2008/9**	**2009/10**	**2010/11**	**2011/12**	**2012/13**
CPI (annual average)	7.3	14.2	9.4	6.5	23.5	5.8
CPI (end of period)	8.0	12.5	7.8	6.3	24.3	3.6
Food (end of period)	5.4	27.9	16.5	9.3	30.6	-1.4
Non Food (end of period)	7.9	8.9	6.7	5.7	20.3	6.5

Source: Uganda Bureau of Statistics

Table A 9: Inflation rates (for selected items) 2011-2013

	2013												2014			
Items	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**
All items	4.9	3.5	4.0	3.4	3.7	3.6	5.1	7.3	8.4	8.1	6.8	6.7	6.9	6.8	7.1	6.7
Food	0.0	-2.0	-0.9	-2.6	-2.1	-1.4	2.8	9.1	11.7	10.9	8.1	9.2	-0.7	11	12.7	12.2
Food crops	3.0	-6.2	-8.5	-7.5	-5.2	-6.2	-0.2	12.9	5.3	-1.1	-4.3	0.0	0.2	25.2	28.3	25.4
Non food	7.2	6.0	6.5	6.6	6.8	6.5	6.5	6.8	6.6	10.9	8.1	9.2	5.7	5.1	4.7	4.2
Beverages and tobacco	12.0	12.6	14.0	13.7	12.3	12.3	13.0	13.7	14.8	12.3	13.1	8.7	-1.2	2.7	1	0.8
Clothing and footwear	-4.4	-4.8	-2.9	-1.0	1.5	6.1	8.4	9.6	10.7	13.1	10.0	10.6	-0.5	9.2	5.4	4.6
Rent, fuel and utilities	3.9	3.9	3.8	4.8	6.4	6.4	5.9	5.3	5.8	4.1	4.7	4.8	0.8	2.2	3.1	2
Household and personal goods	5.4	4.4	4.5	4.9	4.3	3.5	3.8	3.7	3.6	4.0	4.0	4.3	-0.2	2.6	2.3	1.6
Transport and communication	2.5	4.0	4.7	4.3	4.1	4.9	4.0	6.6	5.9	6.8	4.3	1.8	-1.5	5	4.4	4.6
Education	15.8	8.2	8.2	8.3	8.0	4.3	4.5	4.2	4.8	4.8	4.8	4.8	0.1	6.1	5.9	5.8
Health, entertainment and others	9.9	9.8	10.1	9.0	8.0	8.5	8.5	8.6	8.9	8.7	8.1	8.0	1.0	6.9	6.5	6
Other goods	1.2	3.0	5.0	3.5	3.4	4.4	5.7	5.6	6.6	6.4	6.6	5.2	2.8	1.4	1.1	1
Services	10.1	7.3	7.6	7.9	7.8	7.1	6.8	7.4	6.7	7.5	6.7	6.2	6.6	6.9	6.7	6.2

Source: Uganda Bureau of Statistics

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