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Country Economic Report 2006:3

Challenges for Pro-Poor Growth in Uganda

Foreword

This country economic report explores the challenges for achieving sustainable pro-poor growth and poverty reduction in Uganda, against the backdrop of an increasing disillusion with Uganda's performance in these regards in recent years. It is found that past successes and an excessive belief that macroeconomic stabilisation and investment in human development more or less automatically would translate into pro-poor growth have diverted attention from the need to think through the challenges of achieving sustained pro-poor growth. The study concludes that breaking the present trend of stagnation in poverty reduction will require (l) addressing the issue of population growth, (ii) a rapid and sustained intensificationof agriculture, and (iii) a diversification of the economy through the development of the non-farm sectors. The study was produced as an analytical input into Sweden's forthcoming collaboration strategy with Uganda. It is also part of an on-going methodological work within Sida (a cooperation between the Department for Infrastructure and Economic Cooperation and the Department for Policy and Methodology) aimed at achieving a sharper poverty focus in economic analysis.

The study is part of a series of studies, undertaken by Sida itself and by various Swedish universities and academic research institutes in collaboration with Sida. The main purpose of these studies is to enhance our knowledge and understanding of current economic development processes and challenges in Sweden's main partner countries for development co-operation. It is also hoped that they will have a broader academic interest and that the collaboration will serve to strengthen the Swedish academic resource base in the field of development economics.

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Content

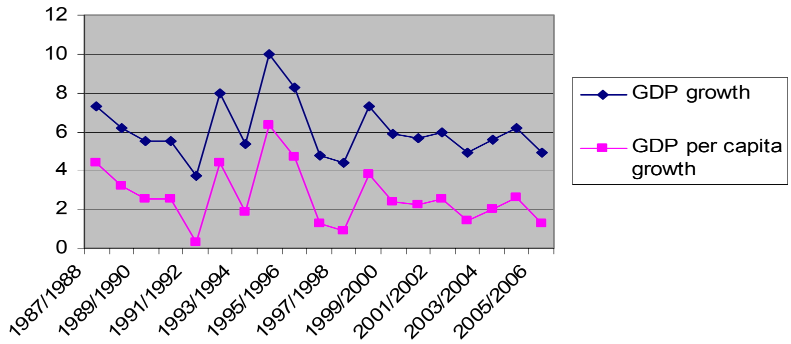
1 The Development Context in Uganda

The economic development and poverty reduction in Uganda since the fall of Idi Amin has in many ways been noteworthy. The incidence of poverty has decreased from 56 percent of the population in 1992 to 44 percent in 1997 and 38 percent in 2003. However, the impressive achievements to date must not obscure the fact that Uganda is still in a very early development phase, demographically as well as economically. The demographic transition has just begun. While death rates have fallen, fertility and birth rates remain at very high levels resulting in rapid population growth. One explanation behind the continued high rate of fertility is most likely the low level of gender equality in Uganda. The high rate of population growth implies that very high rates of growth are needed to achieve satisfactory per capita growth. Even though the annual GDP growth averaged 5.5 percent 2000–2004, the GDP per capita growth was only 2.1 percent. The economy is still profoundly agrarian, the modern non-farm sector is still in its infancy and urbanisation is very low. Per capita GDP was only 285 USD in 2005. Moreover, even though Uganda has liberalised trade, it is still a fairly closed economy when it comes to the actual trade flows. Exports made up only 12 percent of GDP in 2004/05. Uganda is also very dependent on ODA, which covers 48 percent of government revenue and equals 9–10 percent of GDP. On the other hand, Uganda has made considerable improvements in education and health compared to other countries at the same development level.

Uganda has some country-specific features that has affected and can be expected to affect the economic development. It is land-locked, which means that geography imposes a 'tariff' through high transport costs, on both exports and imports. This has implications for Uganda's international competitiveness. Moreover, the geographic location close to violent conflicts in both Sudan and the Democratic Republic of Congo contributes to insecurity, and hence investment incentives, also in Uganda. Uganda itself has also had a very troubled past, and the security situation in the northern, and to some extent also the eastern, parts of the country is still very bad, even though peace and security have improved. Uganda is also one of the few success stories in Africa when it comes to combating HIV/AIDS. The adult prevalence rate fell from 18 per cent in the early 1980s to 6–7 per cent in 2005. However, the decline has levelled off and there are indications that the infection rate is increasing again.

The impressive economic development and poverty reduction to date has to a large extent been based on discrete events; i.e. favourable circumstances, events and reforms, which have yielded large once-off bonuses in terms of growth and poverty reduction (see Figure 1.1). These cannot be expected to drive future growth although they remain essential preconditions. The most outstanding discrete events have been the peace dividend after 1986, economic liberalisation and macroeconomic stabilisation in the early 1990s and the significant increase in foreign aid. The coffee price boom in the mid-90s also contributed to a marked, but short-lived, boost in growth and poverty reduction. Peace, liberalization and macroeconomic stability have had a particularly large positive impact on economic growth since Uganda started from a very low level of economic activity, but also since the additional cost of doing business due to insecurity, inaccessibility to international markets and economic instability decreased significantly. However, the benefits of these reforms have to a large extent been reaped by now and growth has slowed down. Thus, over the six year period 1991/92–1996/97 GDP increased by 42 per cent and per capita GDP by 20 per cent. Over the subsequent six year period, 1997/98–2002/03, the increases were only 34 and 13 per cent, respectively.[1] This trend of declining rates of growth has continued into the present. Unless the rate of investments increases significantly sustained high rates of growth will be difficult to achieve. ODA, another once-off increase, doubled from 5 to about 10 percent of GDP between 1997/98 and 2004/05. This had a major effect on growth of services, mainly through increased expenditures on education and health. Even though Uganda may expect high levels of ODA also in the future, further increases in ODA as a share of GDP are not on the agenda. Hence, any growth effects from aid flows will be determined by the extent to which they are fostering growth-enhancing activities.

Figure 1.1 GDP and GDP per capita growth rates in Uganda 1987/98–2005/06. Percentages



Sources: Kabanaukye *et.al.* (2006:365); Uganda Bureau of Statistics (2005a).

Economic growth that is highly dependent on export of a single cash crop is very vulnerable to changes in terms of trade, as the boom and bust of coffee as an engine of growth in the 1990s clearly exemplifies. While the importance of exports for growth is undeniable, sustainable growth also needs to be built on increasing and stable domestic demand, and a development and deepening of domestic production linkages. To secure sustainable high rates of economic growth in the years to come Uganda needs a viable private sector that increases the productive

[1] Kabananukye *et.al.* (2006:365).

capacity in the economy continuously through competitive pressure, and responds with higher investments rates. Peace, a liberalised economy and macroeconomic stability are pre-conditions for this, but the engine of this type of growth will need to be a more productive real economy.

The extent to which growth has been pro-poor has also been determined by specific interventions and external factors. Favourable coffee prices in the early 90s clearly affected the poverty-bias of growth, and the subsequent slowdown in the pace of poverty reduction may to a certain extent be a natural consequence of the decrease in coffee prices. The reduction in poverty that has occurred despite the unfavourable changes in terms-of-trade has partly been driven by increased donor support to health and education. However, Uganda can not expect continued increases in donor support or pro-poor changes in the terms-of-trade. Poverty reduction will not be sustainable as long as it is primarily based on redistributive factors. For pro-poor growth to become sustainable it must be based on growth in which the poor are given opportunities as economic actors, i.e. economic development that creates productive employment opportunities for the poor.

Economic prognoses in Uganda based on trend extrapolation, in turn based on past successes, are therefore likely to be misleading since the favourable discrete events that have boosted growth and poverty reduction in the past cannot be expected to be repeated; except, hopefully, for the establishment of peace and security in the north and east. Continued economic growth and poverty reduction will require (i) productivity gains in agriculture (both with regard to labour and land) and (ii) economic diversification, i.e. development of the non-farm sectors. Economic diversification is not only necessary since there will be natural constraint to agricultural productivity gains, but also in order to decrease exposure to dramatic terms of trade changes and to increase predictability. As discussed in greater detail below, it will also require a fall in fertility and birth rates, as the very high rate of population growth implies that even fairly high rates of growth result in only modest per capita growth as well as, arguably, renders sustained high growth difficult to achieve.

A focus on the poor as creators of growth calls for a focus on employment and labour productivity in economic analysis. The methodological approach in this study takes the human resources and the need to create conditions conducive to unleashing the creative and productive forces inherent in this resource base, with particular emphasis on the poor, as the starting point of the analysis. Enhancing employment and the returns to labour by (i) strengthening the productive resources and capacity of the individual people, in particular the poor, and by (ii) opening up opportunities for all to make full use of the productive resources at hand, is seen as the main avenue for reducing income poverty and achieving pro-poor growth. Thus, it is crucial to consider the poor not only as consumers who should receive a share of the country's growth, but more importantly as active participants in the economy, which makes an employment analysis necessary, and as independent economic agents (it should be recalled that in Uganda, as in most developing countries, the vast majority of the labour force is self-employed), which points to the importance of a business climate analysis. Employment and the remuneration derived from employment are determined by the supply and demand for labour. An employment analysis casts light on the supply side of labour and the functioning of the labour market, while a business environment analysis gives insights on the level of, potentials for and constraints to economic activities and the resulting demand for and, through productivity, returns to labour.[2]

Section 2 describes the current employment situation. It also discusses the need for increasing employment and income opportunities in coming years and the implications for economic development. Section 3 presents three challenges for growth and poverty reduction and their potential effects for Uganda. The challenges discussed are (i) turning the demographics into an advantage, (ii) managing the upward pressure on the exchange rate, and (iii) facing up to an increasing international competition. Section 4 concludes the analysis. In the final section the PEAP and the new MTEF are discussed in relation to the findings of the analysis.[3]

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[2] For a further methodological discussion see Lundström and Ronnås (2006).

[3] For two other recent studies on pro-poor growth in Uganda, see Okidi *et.al.* (2005) and Kabananykye *et.al.* (2006).

2 The Labour Force and the Need to Enhance Employment and Income Generation

2.1 The Labour Force and Labour Productivity

Uganda's broad based population pyramid – half of the population is under the age of 15 – is reflected in a high dependency ratio – i.e. a rather small labour force in relation to the total population – but also in a young and rapidly growing labour force. More than 600,000 young people enter working age every year, resulting in an annual growth rate of the labour force well in excess of 3.5 percent per year. The increase in the human resources is not only quantitative, but also qualitative. Large investments in education over the past years imply that the educational level of the labour force is increasing, albeit from a very low level. However, HIV/AIDS remains a major concern to the health status of the labour force (as well as obviously to the population at large). Enterprise surveys have revealed an anxiety about the impact of HIV/AIDS, reflected not least in high rates of sick leave. This expressed concern is likely to be the top of an iceberg. The vast majority derive their income from small holder agriculture or self-employment in the non-farm sector where the impact of loss of labour and incomes from labour due to HIV/AIDS – both directly through illness and death and indirectly from a need to divert labour from productive work to care of sick household members – more often than not has a devastating impact on the households affected. The fact that the economic impact of HIV/AIDS at the micro level it not always clearly reflected at the macro level (not least due to poor statistics and data) is no excuse for belittling the severity of HIV/AIDS as an obstacle to poverty reduction.[4]

Still, the overall picture is one of rapid increases in the human and productive resources of the country, at the same time as the challenge to deploy these resources productively through increased employment opportunities and at increasing levels of productivity must be met.

[4] For an in-depth analysis of the economic impact of HIV/AIDS, see Arrehag *et.al. (2006)*.

Table 2.1 Labour force by industry. Percentages.

Industry	Female	Male	Total
Primary	75.5	61.8	68.7
Secondary	5.1	10.3	7.8
- Manufacturing	4.9	7.3	6.1
Tertiary	19.4	28.2	23.5
- Trade	9.4	13.8	11.6
All industries	100	100	100
All industries (1000)	4,642	4,618	9,260

Source: Labour force Survey 2002/2003 (2003:Table 4).

Remarks: Primary includes agriculture, hunting, forestry and fishing

Secondary includes mining, manufacturing, electricity, gas, water, construction

Tertiary includes all others.

Uganda remains a profoundly agrarian society. By 2002, some 87 percent of the labour force was rural and well over two thirds derived their living from agriculture, forestry or fishing (Table 2.1 and 2.2). As can be seen in Table 2.2 a mere 5 percent of the labour force has permanent wage employment; the vast majority – 85 percent – are self-employed, while the remaining 10 percent derive their living from casual wage employment. Hence, agriculture and the informal non-farm economy provide employment for the overwhelming majority of the labour force as well as for the bulk of the new entrants into the labour force. Even in urban areas, less than 14 percent of the labour force had permanent wage employment in 2002. Employment in the services sectors, not least in trade, account for the mass of the non-farm labour force. In 2002 a mere 6 percent were employed in manufacturing.

Table 2.3 reveals that there are huge differences in productivity between agriculture and the non-agricultural sectors as well as within the non-agricultural sector. Labour productivity in agriculture is less than half of the average for the economy as a whole. As might be expected, labour productivity in manufacturing is well over the national average, while that of trade is close to the national average, no doubt reflecting widespread employment in informal petty trade yielding low returns to labour.

Table 2.2 Labour force by employment status.

	Rural	Urban	Female	Male	Total
Self-employed	89.6	61.0	91.9	79.9	85.6
Wage workers	9.7	39.0	8.2	20.3	14.3
- Permanent	2.2	13.7	2.8	6.1	4.5
Total (000)	8,033	1,228	4,642	4,618	9,260

Source: Labour force survey 2002/2003 (2003:Table 4.1).

Table 2.3 GDP, labour force and productivity by main industries.

Industry	GDP	Labour Force	Productivity
Primary	32.4	68.7	47
Secondary	22.1	7.8	283
- Manufacturing	10.2	6.1	167
Tertiary	45.5	23.5	220
- Trade	11.7	11.6	101
All industries	100	100	100

Sources: Labour force survey 2002/2003 (2003:Table 2); Uganda Bureau of Statistics (2005a:Table 2).

Women are distinctly disadvantaged in the labour market. They are considerably overrepresented in agriculture and among the self-employed. A mere 8 percent of the female labour force work for wages, as against 20 percent of the male labour force, and less than 3 percent hold permanent wage work (Table 2.2). Not only are women underrepresented among the wage employed, but they also earn considerably less than their male counterparts. In 2002 some 54 percent of the female wage workers earned less than 20,000 shilling per month, as against 34 percent of the men.[5] Although educational levels still are somewhat lower for women than men, such differences alone can hardly explain the greatly different position of women and men on the labour market. Unequal access to employment opportunities clearly also play a role.[6]

Open unemployment and, in particular under-employment, is widespread, reflecting an inability of the economy to generate adequate employment opportunities for the labour force. Open unemployment is largely an urban phenomenon, associated with wage employment, and as a consequence of limited magnitude. Still, some 3.2 percent of the labour force was openly unemployed in 2002; 12 percent in urban areas and less than 2 percent in rural areas. Among the urban labour force, female unemployment, at 16 percent, was more than twice as high as male unemployment. Visible underemployment, defined as those working less than normal duration and seeking and being available for additional work stood at 15 percent.[7] In addition, it is clear that a very large share of the labour force is unemployed in the sense that people work long hours at such low levels of productivity that the incomes earned from work, whether in cash or kind, do not suffice to escape from poverty. Hence, the challenge is not only to create employment opportunities at pace with the rapid growth of the labour force, but also to increase employment opportunities and not least productivity in existing jobs.

The participation rate in the labour force is comparatively high, both among men and women. For those aged 20 to 60 it exceeds 90 percent for both sexes.[8] However, some 55 percent of the male and 75 percent of the female labour force worked less than 40 hours in 2002. The very high share of women working less than full time may reflect a time constraint due to a heavy burden of reproductive work, but it can also be assumed that many, perhaps not least men, simply lacked full time employment opportunities.

2.2 Future Employment and Income Opportunities

The profoundly agrarian nature of the Ugandan economy implies that the agricultural sector must be a cornerstone in the economic development in the years ahead, a fact that is also recognised in the Poverty Eradication Action Plan (PEAP). The need to reduce poverty more effectively and to halt and if possible reverse the trend over the past decade of increasing income inequality calls for a growth strategy based on two pillars: intensification of agriculture with a focus on small-scale farmers and a broad-based and rapid development of the non-farm sectors. The need for such an approach is further underscored by the seemingly low level of mobility of the labour force; occupationally as well

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5 Labour force survey 2002/2003 (2003:Table 4.8).

6 The gender aspects of development deserve particular attention. As discussed above, women are severely disadvantaged on the labour market. Removing gender-based obstacles for women to access productive employment opportunities is obviously important in its own right, but also as one of several means to foster a fall in fertility (as discussed below).

7 Labour force survey 2002/2003 (2003); MFPED (2004b).

8 Labour force survey 2002/03 (2003).

as geographically. The fact that large regional and rural–urban differences in standards of living have apparently not triggered any major migratory flows – except for refugees from areas suffering from violent conflict – as well as large wage differences between sub-sectors of the economy and between regions are a testimony of low mobility. This implies a short to medium term need to focus development efforts to the areas and sectors where the poor are found, in order for growth to become more pro-poor and to counteract tendencies towards increasing income inequality. However, in the medium to long run a flexible labour market, in terms of geography as well as occupation, will be crucial for the poor to seize the opportunities created by growth and structural changes, not least driven by an increased openness of the economy.

The small size of the modern non-farm economy implies that even at very high rates of growth it will only be able to absorb a minor share of the increase in the labour force in coming years. Agriculture will by necessity remain the main source of employment and incomes in the short to medium term future. A quite forceful and sustained intensification of agriculture will be required as agriculture will have to generate substantial additional employment during the coming five years at the same time as labour productivity needs to be increased considerably in order to reduce the widespread income poverty and underemployment in agriculture. This presents a formidable challenge. Returns to land have to increase significantly in order to make possible improvements in livelihoods and returns to labour in agriculture at the same time as the agricultural population and labour force continues to increase at a high rate. Fortunately, the scope for intensification of agriculture seems to be quite good. For most parts agriculture is still rather primitive and subsistence-oriented and characterised by a 'low input – low output' mode of production. Extension services are poorly developed, reaching only a small minority of the farms and access to market information is similarly poor.[9] Most farmers use little or no cash inputs The 1999/2000 survey revealed that a mere 12 percent of the farmers used improved or hybrid seeds, 2.5 percent used inorganic fertilizers and 6.4 percent applied pesticides More than 90 percent of the farms did not apply any fertilisers at all.[10] Yields and returns to land are correspondingly low. For instance, average yields of maize, a main food crop, is no more than 1,700–1,800 kg/ha, which is estimated to be less than a fourth of the potential.[11] In view of the rapid population growth and the infant state of the modern non-farm sectors, concerted efforts to intensify agriculture are imperative to prevent a situation where the farm population becomes caught in a poverty trap, where increasing population pressure on land combined with stagnant or very slow growing levels of production and yields, at a low level of production, results in decreasing returns to labour and labour productivity and stagnant or falling farm incomes.

An intensification of agriculture would also greatly enhance the prospects for a sustainable and rapid development of the non-farm sectors. An improvement of agricultural production and incomes resulting from intensification would, through increased local demand provide incentives for non-farm private sector development resulting in enhanced non-farm employment and income opportunities, which in its turn would create more exit opportunities for labour from agriculture, leading to

[9] According to the 1999/2000 national household survey, a mere 11 percent of the farms benefited from extension services and less than 30 percent had access to market information (Crop Survey 1999/2002 (2002:4–5)).

[10] Crop Survey (2002:20). The figures refer to the first season.

[11] Nabbumba and Bahiigwa (2003).

higher incomes for those remaining on the farm. A beneficial circle, based on pull rather than push factors can then drive a structural change and growth based on a movement of labour from agriculture into more productive employment opportunities in the non-farm sectors.

3 Challenges and Opportunities

3.1 Turning Demographics into an Advantage

As mentioned above, the very high rate of population growth and the sustained high rates of fertility impose a formidable challenge for reducing income poverty, as economic growth not only has to keep pace with population growth, but has to exceed it with a considerable margin in order to bring about noticeable improvements in per capita growth and incomes. At the current rate of population growth of 3.6 percent, the target rate of economic growth of 6–7 percent should rather be considered as a minimum. Furthermore, such a growth rate must be combined with unchanged, or preferably improved, income distribution if the poverty targets are to be met. In the absence of major structural changes in the economy, this implies that growth in the agricultural sector, which is the main source of employment and income to the overwhelming majority of the population, must be considerably higher than the rate of population growth. The past years have clearly demonstrated how difficult it is to achieve such growth.

In the medium to long term it is reasonable to expect that it will be nearly impossible to achieve fast and sustained reduction in income poverty unless fertility and by consequence population growth falls. First, economic growth in the magnitude of 6–7 percent or more requires very high rates of investments, at the same time as the large sizes of households and a very unfavourable dependency ratio make domestic savings very difficult. Foreign capital can to a certain degree make up for this, but hardly to the extent required. Second, increasing population pressure and a falling land/labour ratio in agriculture implies a need for very rapid increases in the returns to land for agriculture to be able to generate both more employment opportunities *and* higher labour productivity and incomes. Although there still seems to be considerable scope for intensification of agriculture, sooner or later marginal returns to land will begin to decline. In the long run agriculture will not be able to accommodate a rapidly increasing population *and* sustained and high rates of income growth from agriculture.

A prognosis of the demographic development based on forecasts from the United Nations Population Division (Table 3.1) highlights both the challenges and the opportunities inherent in the demographic dynamics. According to this prognosis, the total fertility rate will fall gradually from 6.8 at present to 2.9 in forty years' time. As the same time, and as a result of falling fertility, the rate of population growth will fall from 3.6 percent at present to 3.3 in 2020 to 2.1 in 2045. Meanwhile, the total population of Uganda will increase from about 27.6 million at the present to over a 100 million by 2050. The much slower pace of decline of the population growth than of fertility is due to fact that even with a sharp fall in fertility, the number of women entering the fertile age groups will continue to increase rapidly over the next decades due to the very large share of children in the population at present. The impact of falling fertility and birth rates on the growth of the labour force will be even slower, as there is a time lag of about 15 years before falling birth rates translate into a slower growth in the labour force. Hence, according to the prognosis presented above the labour force will continue to grow by between 3 and 4 percent over the next three to four decades. In absolute terms this implies that the annual growth of the labour force will increase from about 600,000 a year at the present to about a million a year 2020–2025, to a peak of 1.3 million a year by 2030–2035. The challenges of achieving a sustainable economic development capable of providing employment opportunities, at increasing levels of productivity and incomes, for such a very rapid growth of the labour force over a long period of time is very alarming indeed.

Table 3.1 Demographic projections.

Year	Population (000)	Pop Growth %	TFR	Dependency ratio	Pop. Aged 15–64	Growth 15–64, %
2000	23,487	3.30	7.1	110	11,616	3.16
2005	27,623	3.62	6.8	112	13,044	3.67
2010	32,996	3.58	6.4	111	15,621	3.88
2015	39,335	3.46	5.9	108	18,894	4.06
2020	46,634	3.31	5.4	102	23,051	4.00
2025	54,883	3.11	4.9	96	28,051	3.86
2030	63,963	2.84	4.3	89	33,894	3.38
2035	73,550	2.53	3.7	82	40,522	3.38
2040	83,344	2.27	3.2	74	47,844	3.12
2045	93,250	2.06	2.9	67	55,801	2.79
2050	103,248			61	64,039	

Source: Klasen (2005), see also MFPED (2004b).

Remarks: Growth rates refer to annual growth rate in the 5 year interval between the row where the data is entered and the subsequent one. TFR = Total fertility rate. Dependency ratio calculated as the number of dependents (below 15 and above 64) divided by the working age population (aged 15–64) times 100. All original data from United Nations Population Division (2002).

The prognosis presented above is obviously not cast in stone. Other countries, notably in East and Southeast Asia, have registered a much faster decline in fertility than the forecast for Uganda in Table 3.1 suggests.[12] Changes in reproductive behaviour and preferences can impact fertility quite rapidly and sharply, which would turn these demographic dynamics into important opportunities for income growth and poverty reduction. At present, because of the very high share of children below working age in the population, the dependency ratio is highly unfavourable. Every breadwinner has to support not only him/herself, but also 1.2 non-economically active persons (mainly children). A fall in fertility would almost immediately result in a gradual improvement of the dependency ratio. The growth rate of the number of young (who are not yet in the labour force) would slow down, while the growth rate of the labour force would remain high and even increase for another 15–20

[12] Examples are China, Thailand and Vietnam.

years. This would result in a sharp improvement in the dependency ratio, which holds the potential of a substantial positive impact on poverty reduction. This impact can take several forms.

First, a fall in the dependency ratio will automatically translate into higher per capita income as long as the economy manages to generate employment opportunities for the growing labour force at least constant (or higher) levels of labour productivity. This is simply because the share of income earners in the total population increases. A rough calculation suggests that this effect alone could result in an increase in per capita economic growth in Uganda of 1.5 to 3 percent per year.[13]

Second, an improved dependency ratio would substantially increase the domestic capacity to save, not least at the household level. Savings, which in their turn translate into productive investments (resulting in higher economic growth), creation of more and better employment opportunities, and higher return to labour. Empirical evidence from elsewhere also shows that with fewer children parents are able to invest more in the education of their children. In order to achieve sustained economic growth at 6–7 percent per year, it is estimated that domestic private investments will have to increase by about 10 percentage units from its present level of 18 percent of GDP. This will require a more or less corresponding increase in the levels of domestic savings. It is difficult to see how this could be achieved without a fall in the dependency ratio.

Third, having fewer children reduces the burden of reproductive work that tend to weigh heavily on women, thus easing the time constraint on women, making it possible for them to engage more extensively and fully in economic production.

Fourth, a fall in fertility would, with a 5 to 6 years time lag, begin to ease the burden of public expenditures on education as the rate of growth of school-age children would slow down. This, in its turn would create some fiscal space which could be used to expand secondary education, improve the quality of education and/or for other development enhancing purposes.

By way of summing up, it may be concluded that at present the very high rates of fertility and population growth imposes a binding constraint on sustained poverty reduction and economic development in Uganda. At the same time, a reduction in fertility would create highly conducive conditions for increased rates of per capita economic growth and poverty reduction.

The means for reducing fertility are fairly well established and may be summarized as: improved education, employment and income opportunities, sexual and reproductive rights and empowerment more generally for women. Data from the Ugandan Demographic and Health Survey (UDHS) shows that fertility falls sharply with the level of education, from 7.8 for women with no education, to 7.3 for those with some primary education, to 3.9 for those with at least some secondary education. Improved employment and income earning opportunities beyond subsistence agriculture would be another important contributor to fertility reduction. The results of the UDHS also show that improved sexual and reproductive rights would also have a positive impact on fertility, as the actual number of children exceeds the number desired by women and as men tend to be in favour of having more children than women.[14] Such measures are also crucial for the equally important goal of counteracting the spread of HIV/AIDS.

[13] Klasen (2005).

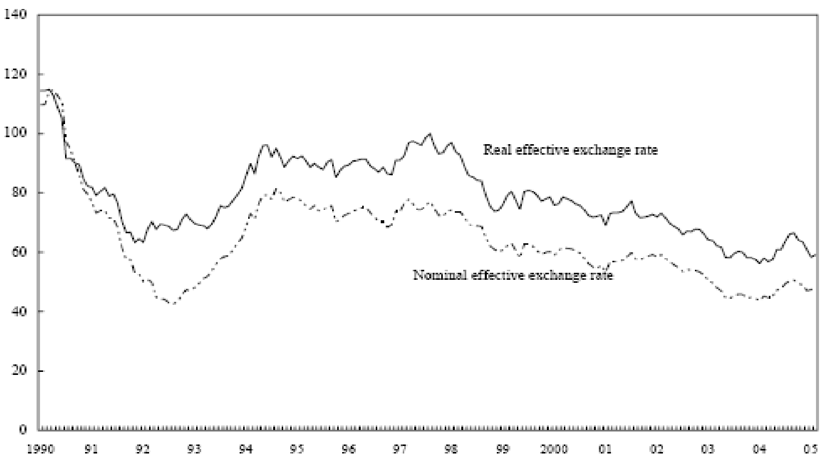
[14] Klasen (2005). See also MFPED (2004).

3.2 Managing the Upward Pressure on the Exchange Rate

Uganda liberalized the exchange rate in late 1980s and the Bank of Uganda is now managing the monetary policy according to an inflation target. This means that the exchange rate will be market determined and hence reacts to the supply and demand of the Uganda shilling in relation to the supply and demand of foreign currency. Increased exports, remittances to Uganda, FDIs, ODA, etc will increase the inflow of foreign currency and put an upward pressure on the shilling, i.e. an appreciation pressure. Increased imports, remittances from Uganda, portfolio investments abroad, etc will instead create a depreciation pressure. An appreciation will decrease the profitability and/or competitiveness of exports since the foreign exchange earned will translate into fewer shillings, at the same time as the cost of import decreases and reduces the competitiveness of domestic products as compared to imported ones. This affects the possibilities for an export-oriented growth, which is a spelt out goal of the PEAP.

An appreciation of the Ugandan shilling will also have redistributive effects and therefore an implication for the pro-poorness of growth. Generally speaking, the richer segments of the population will benefit from an appreciation as their consumption tend to have a high content of imports, while the producers of cash crops in particular, i.e. mainly poor rural people, loose out. Although the absence of detailed income-expenditure data makes it difficult to quantify these effects, the negative consequences of an appreciation deserve to be taken seriously, not least because those in a position of decision-making are perhaps likely to belong to the winners rather than the losers.

Figure 3.1 Nominal and real effective exchange rate 1990–2005.



Source: IMF (2006a:9).

Looking at the movement of the exchange rate in Figure 3.1, it is clear that there have been some more or less distinct periods. The sharp fall in the exchange rate in the beginning of the 90s can be ascribed to the adjustment of the shilling to the market rate. By 1992/93 the misalignment has been broadly corrected by the liberalisation, including the absorption of the black market exchange.[15] According to Nkusu (2004), during the period 1992/93 to 1995/96 there was, on an annual average basis, an appreciation of the real effective exchange rate of 7.5 percent

[15] Henstridge and Kasekende (2001).

while the terms of trade improved by 16.6 percent. Between 1996/97 and 2000/01 the real effective exchange rate depreciated by an annual average of 1 percent, while the terms of trade deteriorated by 8 percent. This trend continued for a few more years but there are now concerns that the exchange rate is entering a new period of appreciation. The period of depreciation was driven by deteriorating terms of trade, but there were clearly factors that hampered the effect, i.e. factors that created an upward pressure on the exchange rate. Although it is difficult to exactly measure the extent of this pressure or the precise contribution of ODA, it is certain that the increased inflow of ODA after 1997 when the PEAP was introduced added to that. A recent unpublished study suggests that all in all ODA at its present levels is likely to have led to an increase in the value of the Uganda shilling of between 30 and 75 per cent.[16] It should be noted that the impact of the inflow of ODA on the exchange rate is not always revealed by the actual movements and level, but should be measured by the difference between the actual movement and level in the exchange rate and the movement and level that would have been without ODA.

The movements of the exchange rate depend in turn on the responsiveness of the in and out flows of foreign currency to changes in the exchange rate. In a situation where the flows are sensitive to the exchange rate, an appreciation would result in reduced inflows of foreign currency and an increased outflow, easing the upward pressure on the exchange rate, and vice versa. The problem arises in a situation where a significant share of the foreign currency flows are insensitive to the exchange rate, as is the case in Uganda with regard to particularly ODA, but also remittances to some extent. In 2004/05, ODA was volume-wise equal to exports – 890 and 857 million USD respectively – while ODA plus private transfers (mainly remittances and NGOs) are 1.5 times larger than exports.[17]

The export sector is fairly responsive to changes in the exchange rate and in world market prices since it is mainly made up of cash crops, primarily coffee, that can be replaced by another type of production, at least over a period of some years. This can be compared to countries exporting natural resources, such as copper in Zambia where there is no alternative use of the mines and therefore fewer incentives to decrease exports.[18] Another factor affecting the impact of an appreciation on domestic profitability and competitiveness is the import content of the exports. A fall in the profitability of exports due to an appreciation can be partly off-set by lower costs of production as imported inputs become cheaper. However, in Uganda most exports are non-processed agricultural products with very low import content in the production, implying that the negative impact of an appreciation on exports is not cushioned. Imports are mainly consumption goods and energy, even though there is a trend towards increased investment and input goods in the imports.

Hence, it may be concluded that: (i) the Ugandan shilling has been subject to considerable appreciation over the past decade and there will continue to be an upward pressure on the currency; (ii) this hurts export-led growth in particular and growth in general, and (iii) hurts the rural poor in particular and tends to exacerbate income inequality.

So, what should be done? It is important to remember that the source of the upward pressure on the exchange rate is something positive for the

[16] (The) Macroeconomic Management of Aid Inflows (2006).

[17] IMF (2006:24).

[18] This effect is usually referred to as the resource curse.

economy, be it ODA, remittances or exports. Managing the effects of an appreciation is therefore a matter of increasing the benefits of the source of the appreciation as well as decreasing the negative effects. First of all it is essential that the inflow of foreign currency is used to improve the business environment in order to compensate for the lower profitability/competitiveness of exported products and the increased competitiveness of imports over domestic products. With regard to ODA, the tendency has been to invest in the non-tradable sector such as education and health. This has a value in itself but will only compensate for the negative effects of an upward pressure of the exchange rate in situations where these factors are binding constraints and a significant marginal contributor to increased efficiency of production and higher productivity. Given the government and donor bias towards the non-tradable sectors in Uganda, it is likely that there are other constraints in the business environment that need to be addressed in order to enhance the competitiveness of the economy to counter the negative impact of the upward pressure on the domestic currency.

Another response to the pressure on the exchange rate from ODA can be to invest in more import intensive activities such as infrastructure. The intention of the PEAP to focus on infrastructure is therefore welcome for this as well as other reasons. However, increasing the import content in investments is not a long-term solution and it is important that the investments actually serve to improve the efficiency and competitiveness of the domestic economy and hence the possibilities for production linkages and multiplier effects in the country itself.

Finally, it is important that the monetary policy response to inflation pressure is as efficient as possible. The Bank of Uganda can intervene in the foreign exchange market to even out short term fluctuations in the exchange rate, but essentially leaves it to the market to determine the exchange rate. Hence, there is no target for the exchange rate, but only for the rate of inflation. The Bank of Uganda has mainly been using two monetary instruments to ensure low inflation – sale of foreign exchange and issuing of treasury bills – both of which exert a downward pressure on inflation through monetary contraction.[19] However, beside their positive impact on inflation, both instruments have negative effects or costs as well. Sale of foreign exchange pushes up the exchange rate even further, to the detriment of economic growth and competitiveness. Issuing of treasury bill results in increased interest rates and availability of credits for the private sector, i.e. constraining the productive sectors even further, thus negatively affecting the rate of investment and by implication growth. Moreover, the public expenditure that are needed to cover the interest cost is estimated to about 1.5 per cent of GDP, which equals well over 10 per cent of the public domestic revenues.[20] These costs should be weighted against the benefits to businesses of a low and predictable inflation.

The relatively limited role of external trade in the Ugandan economy today implies that the impact of the appreciation of the shilling on economic growth may not have been all that large so far. However, as Uganda puts strong emphasis on export-led growth with an increased integration in the global economy, the problems associated with an upward pressure on the exchange are likely to become increasingly acute and severe. Moreover, as discussed, the economy has in the past benefited from many discrete factors, such as the peace dividend and the

[19] See IMF (2005a:24–25) for a discussion on the effects and optimal mix of inflation policy instruments in Uganda.

[20] (The) Macroeconomic Management of Aid Inflows (2006).

establishment of macroeconomic stability, the impact of which may have compensated for other serious constraints in the economic environment. However, in the absence of favourable external factors affecting the competitiveness of the export sector in Uganda, fostering increased efficiency and competitiveness of the domestic economy government must become a priority issue. In the short term the impact of an appreciation of the currency may well be positive, not least in a situation where the need for energy imports are soaring at the same time as world market energy prices are at a record high. However, such short term gains need to be weighted against the long term losses in terms of foregone growth.

3.3 Facing Up to an Increasing International Competition

As has been argued above, it is crucial that Uganda improves the performance of the real economy and turns the private sector, including the poor as economic actors, into an engine of growth. The development of the private sector has been slow and cannot be taken for granted as past growth to a large extent has been driven by discrete positive events.

Selective import barriers have in some countries been used in order to protect an industry in its early phase of development when its efficiency and competitiveness is still low, with the hope of boosting domestic production. The rational is that a country with infant industry may have too many distortions to solve in the short run or be stuck in a temporary low development trap (fragmentation of markets, lack of economies of scale and agglomeration effects, etc), implying that protecting the domestic production for a limited period would give them the chance to build up a competitive economy. However, experience has shown that such policies carry high risks. In the absence of exposure to international competition and access to the know-how that follows from interaction with foreign firms, technological stagnation and the preservation of inefficient and high-cost domestic industries is often the unintended result.

Uganda has indeed taken the road towards more openness and the PEAP foresees that future growth will be export-led. Openness has according to some calculations been the most important determinant of total factor productivity in Uganda,[21] which confirms the importance of international competitive pressure in order to increase the efficiency in the economy. However, even though Uganda has an open trade regime, its geographic location offers its economy a certain natural protection since Uganda is land-locked. This implies an additional cost, i.e. a 'natural tax', on imports, which gives Ugandan firms competing with the import sector an advantage. Exporting firms on the other hand have a disadvantage due to the 'extra tax' on exports in a land-locked country. This puts additional pressure on exporting firms to become efficient and highly competitive.

As the economies of Uganda as well as those of its neighbouring countries develop and become more specialised and as external trade becomes more important and transport and communication facilities improve the significance of this natural protection can be expected to gradually diminish. It is essential to take this natural protection into account when designing policies and making projections. The identification of potential 'growth sectors' in a situation of natural protection may be misleading as other sectors may turn out as winners once the country is completely exposed to the international competitive pressure. The

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[21] EPRC (2005:30).

protection may conceal the actual competitive pressure that Uganda needs to meet in an export-led growth strategy, but it is also important to seize the opportunities that this protection creates in the short run.

There are calculations showing that the average technical efficiency in Uganda is 0.51, which means that on average firms are only about half as efficient as the best practice firm in Uganda.[22] This is an indication of low competitiveness and segmented markets that in turn might be partly explained by Uganda's natural protection. Disaggregating the results show that 'learning channels' through export experience, work in a foreign firm or advanced education, are important for improved firm efficiency. These are also channels through which the international competitive pressure is revealed and it is important that Uganda's business environment will mature fast enough in order to efficiently respond to this increasing pressure.

Labour productivity in Uganda is very low. The median annual value added per worker in manufacturing is only 1085 USD compared to 2061 USD in Tanzania and 3457 USD in Kenya.[23] Low labour productivity may not be a problem for international competitiveness if it is compensated by low wages. However, even though the wages in Uganda are low, the production output per wage unit is still far from becoming globally competitive. Some reasons affecting the productivity of the labour force in Uganda, such as low or inadequate education and health problems, have been discussed in Section 2 on employment.

On the other hand, the overall capital productivity in Uganda is impressive, despite a capital utilization rate of only 60 percent. The median ratio of annual value added to capital is 0.7, which can be compared to 0.43 in Tanzania and 0.35 in Kenya.[24] One reason is the reconstruction of the economy after the civil war which implies that the capital stock is young. Some 40 percent of the firms have equipment of less than 5 years, and in 35 percent of the firms the equipment is between 5 and10 years.[25] However, the significant excess capacity clearly shows that there is a problem in Uganda's business environment. Improvement in the business environment would not only increase capital utilization but also increase the incentives for further investments. Uganda has still a very low capital intensity, which needs to increase in order to improve labour productivity and total factor productivity, i.e. in order to make Uganda more competitive.

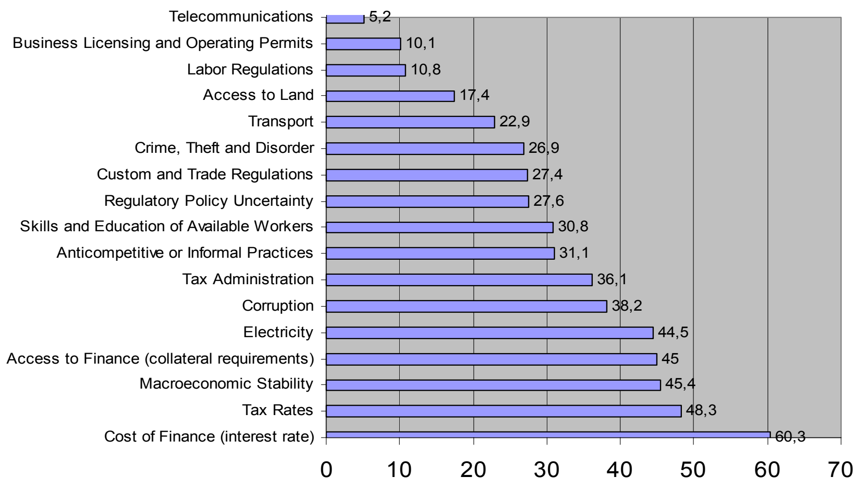
Uganda's domestic savings have improved from very low levels in the beginning of the 90s. Over the past half decade private savings have fluctuated around a slowly rising trend from 14 percent of GDP in 2002/03 to 16 percent in 2004/05, which must be considered to be quite respectable given the low level of economic development and the high dependency ratio. Total domestic savings have increased significantly from 7 to 12 percent over the same period as the domestically financed budget deficit has been reduced, implying that more domestic capital has become available for investments. Total domestic investments have increased marginally from 21 to 23 percent over the same period. Foreign capital, both ODA and private, has made up the difference between total domestic investments and savings. Although both domestic savings and investments compare favourably with many other countries in the region, they need to increase considerably – to about 25–30 percent of

22 World Bank (2004:33).
23 World Bank (2004:31).
24 World Bank (2004:29).
25 World Bank (2004:27).

GDP if the investment needs for sustained rapid economic growth are to be met at the same time as the dependency on ODA gradually is to be reduced.

Uganda's need to improve the business environment in order to boost investments is hence clear. It is not only important for growth in general but for increased employment (self-employment as well as wage employment) and returns to employment. Since sustainable pro-poor growth can only be achieved by creating opportunities for poor people as economic actors, improved investment climate is also crucial for the poor at the same time as improvements in the business environment need to meet the needs, opportunities and concerns of the poor. It is outside the scope of this paper to analyse the binding constraints for businesses in Uganda, but the five major constraints revealed the investment climate survey in 2002/03 (see Figure 3.2) are the cost of finance, tax rates, macroeconomic stability, access to finance and electricity. This emphasises the need for continued macroeconomic stability, a deepening of the financial system and, not least, investment in electricity provision, which furthermore has deteriorated remarkably since the time of the survey. It is also important to analyse the special business environment that the poor meet in their role as producers, i.e. mainly the business environment of the farmer and the small informal enterprises.

Figure 3.2 Manufacturing firms' evaluation of general constraints to their operation, Uganda (percentage of respondents evaluating constraint as major or very severe).



Remark: Data from a survey in 2002/03.

Source: World Bank (2004:38).

Uganda can also affect the natural protection itself by regional integration and cooperation with countries that are not land-locked. The ongoing integration through the East African Community (EAC) is an important step that can deal with regional public goods such as cross-country transport networks and harmonized trade regulations.

4 Conclusions on Main Challenges

Uganda's opportunities for sustainable development and poverty reduction derive primarily from its early stage of development; demographically as well as economically. While the high rate of population growth impose a severe constraint on poverty reduction at present, Uganda has still to draw the benefits of the demographic 'bonus' that can follow from a fall in fertility resulting in a period of two decades or so of very favourable dependency ratio. Similarly, the agrarian nature of Uganda's economy implies that the growth impetus that can result from large productivity gains through a shift of much of the labour force from agriculture to the non-agricultural sectors, based on pull rather than push factors, have yet to be reaped.

The combined effect of a demographic transition driven by a fall in fertility and an economic transition from an agrarian society to a more modern diversified economy can provide the basis for sustained rapid economic growth that is broad-based and pro-poor. This would require a two-pronged economic development strategy focussing on intensification of agriculture and a broad-based development of the non-farm sectors. The relatively low level of integration of Uganda's economy in the world market and its geographic position imply a 'natural protection' against international competition and offer some advantages in the early phase of economic development. Domestic firms can develop and gain strength under the shield of rather low levels of competition at the same time as the competitive pressure gradually increases as Uganda becomes more integrated in the world economy.

However, Uganda faces a race against time if it is to put the country on a path of sustainable economic development and poverty reduction. Although there is still considerable scope for intensification of agriculture, the potential of agriculture as one of two engines of growth is being eroded by increased population pressure on land and a deterioration in the land–labour ratio. There are already signs that increased pressure on land combined with extensive and primitive cultivation practices are taking a toll on environment and on the ability of the poor to derive a decent living from agriculture. In some areas the nutrient content of the land is being depleted by overuse and poor cultivation practices, inequality in access to land is reported to increase and the growth of employment in some services sectors combined with low levels of productivity suggest that people may be pushed out of agriculture rather than pulled by more attractive employment opportunities. A separation of the growth and distributional impact on poverty shows that income inequality within rural areas has increased in recent years (2000–2003) and has more than offset a small positive impact of growth.[26] Although it remains to be confirmed if this development is merely incidental or a trend, it might be wise to see it as a warning sign of a potentially very serious development where rapid rural population growth combined with sluggish growth in agricultural production leads to land differentiation and marginalisation of increasing parts of the agricultural population.

Uganda also has to address a number of specific challenges if it is to succeed in putting the economy on a sustainable path of pro-poor growth.

- First and foremost of these is no doubt the restoration of peace and security in all parts of the country. In much of the north and parts of the east the lack of security and law and order is indeed a binding constraint to growth and poverty reduction.
- Second, even if the security problems are solved, the very large regional and sectoral differences in incomes and poverty levels suggest that pro-active measures will be required to address problems of unbalanced development. Connected to this is the importance of addressing the constraint for labour mobility – geographically and occupationally – since this will affect overall efficiency and growth as well as the extent to which growth is pro-poor.
- Third, the threat of HIV/AIDS to pro-poor growth and poverty reduction deserves renewed attention as the rate of infection shows signs of increasing and as efforts to promote sexual and reproductive health as a means to reduce the risks of infection are fettered by conservative lobby groups within and outside the country.
- Fourth, it requires efforts on several fronts to improve the position of women – education-wise, on the labour market, at home and in society at large – in order to use the whole potential of human capital in Uganda as well as to foster a voluntary decline in fertility and control the spread of HIV/AIDS. It is of course also important in its own right.
- Fifth, the upward pressure on the domestic currency will make a sustained focus on increasing the competitiveness necessary in order to ensure that a gradual integration in the global economy can serve as an engine of growth rather than as a threat. The benefits of inflows if foreign aid must be optimised and weighted against the impacts on the private sector through the exchange rate. Moreover, regional integration must be a priority in order to decrease the competitive disadvantage from being a land-locked country.
- Sixth, monetary policies targeting on inflation control have also implications for competitiveness, e.g. through their impact on the exchange rate and the interest rate. Inflation control should be seen as one of several key means to foster sustainable growth and poverty reduction, and trade-offs should duly be taken into account. This calls for a more long term perspective in the pursuit of macroeconomic policies, including monetary policies.
- Seventh, Uganda needs to increase the productivity and investment rate of the real economy by improving the business environment. Macroeconomic stability and human capital are important parts of a business environment that will foster private investments in Uganda

[26] Okidi et al (2005:31).

but they are far from sufficient, i.e. the limited growth of the real economy so far is not unexpected in that sense. More data collection and analyses are needed in order to identify and learn about the country-specific binding constraints. Uganda's business environment will need to mature fast enough in order to efficiently respond to this increasing competitive pressure from the international market.

In terms of the present study strategies to support pro-poor growth in Uganda the conclusions reveal three general points. The first is to make the need for slower population growth and the fight against HIV/AIDS a dialogue issue, which inevitably must put the situation of women in the centre. The second is the need to support the productive sectors and improve the business environment, not least for the poor. The third is the need for a regional approach when supporting Uganda's trade-led growth strategy.

5 The PEAP and the MTEF

While it is beyond the scope of the present study to make any detailed assessment of the PEAP a few observations – focussing on pillar one and two, i.e. economic management and enhancing production, competitiveness and incomes – can be made against the backdrop of the discussion above.

Table 5.1 Prognosis of long term development of key economic indicators.

	2002/03	2013/14
GDP growth %	5.2	6.5
Inflation	5.2	3.5
Exports as % of GDP	12.3	15.4
Domestic savings as % of GDP	7.3	13.6
- public	- 6.6	
- private	- 13.9	
Total investments as % of GDP	22	28
Private investments as % of GDP	15.6	22.4
ODA as % of GDP	12.	8.5

Source: PEAP 2004/05–2007/08 (2004).

A cursory review raises some comments and questions with regard to the macroeconomic framework.

– Changes in fertility and population growth have a strong bearing on a number of key economic indicators, such as domestic savings. In the absence of a prognosis on the development of key demographic indicators, it is difficult to assess the realism of several of the economic indicators.
– The goal with regard to domestic savings is very modest considering that private savings already in 2002/03 stood at over 13 per cent. Hence, the entire increase in domestic savings over the period can be attributed to a reduction of the domestically financed part of the budget deficit.
– It is difficult to reconcile the projected high rates of investment, which no doubt are required to sustain growth at a level of 6–7 per cent per year, with the modest forecast for domestic savings. In particular when seen against the backdrop of a projected fall in ODA (as a share of GDP), it suggests exceedingly high expectations of increases in FDI. Just as growth in general and poverty reduction in particular,

FDIs also seem to have been driven by one-off events in the past, such as the privatisation wave and the return of previously confiscated properties of expelled Asians.[27]

– Given a professed focus on export-led growth, the forecasts for exports seem very modest. With such a modest growth of exports, combined with low levels of per capita growth in agriculture, which remains the main source of income for the vast majority of the population, it is difficult to see how demand-led growth can be achieved.
– The inflation target seems excessively low. While the price stability achieved over the past decade should not be compromised, there is little if any empirical evidence that inflation below 10 percent hurts growth, at the same time as the cost of short term inflation control through monetary instruments in terms of economic contraction and foregone growth and pro-poor government expenditures can be high.

In practice, it would appear that inflation control has been given priority over growth, even in situations when the inflationary pressure seemingly has been far from alarming. Sales of treasure bills and of foreign currency have been resorted to for the primary purpose of inflation control even though the rate of inflation has remained comfortably low. Thus, in 2003/04 sales of treasury bills and bonds, apparently primarily for the purpose of inflation control, cost the government the equivalent of 1.5 per cent of GDP, money which otherwise could have been spent for development purposes. In addition, these measures entailed indirect costs by soaking up capital that otherwise could have been lent to the private sector, thus pushing up interest rates and crowding out private investments.[28] Although it is difficult to establish the exact the costs and benefits of this very tight reign on inflation, it is also difficult to escape the conclusion that costs in terms of reduced availability of credits for private sector investments and an upward pressure on the currency have not been given sufficient consideration. Inflation control should be seen as one of several means for achieving sustainable growth and poverty reduction. The inflation target and the use of monetary policies should be judged against their contribution to these ends.

Table 5.2 Performance of the economy as a whole and of agriculture. Percent annual growth rates.

	2003/04	2004/05	2005/06	2006/07	2007/08
GDP	5.6	6.2	4.9	6.1	6.6
Agriculture	1.8	1.9	1.2		
GDP/capita	2.0	2.6	1.3	2.5	3.0
Agr/capita	-1.2	-1.1	-1.8		

Remark: Estimates of GDP and agricultural GDP growth per capita based on an assumption of a total population growth of 3.6 per cent per year and an increase of the agricultural population of 3 per cent per year.

Source: MTEF (2005)(2006); Uganda Bureau of Statistics (2005a).

The performance of the economic dimensions of the PEAP has so far been far from satisfactory. GDP growth has been below target and more importantly from the perspective of poverty reduction, growth in agriculture has been dismal. During the first three years of the implementa-

[27] Obwona and Egesa (2004:39).

[28] (The) Macroeconomic Management of Aid Inflows (2006:9).

tion of the PEAP per capita growth in agriculture as well as, most probably, labour productivity in agriculture have been negative (Table 5.2). As the very poor performance of agriculture follows from earlier years of falling rates of growth in agriculture, it is difficult to ascribe it to poor weather or other discrete events alone. In view of the paramount importance of intensification and increasing returns to both land and labour in agriculture as the backbone of a strategy for sustainable economic development and poverty reduction, the stagnation of agriculture is arguably the most pressing economic concern facing Uganda at present.

The poor performance of agriculture stands in sharp contrast to a laudably strong focus on agricultural development in the PEAP. Frustration over the large differences between expectations and outcomes in agriculture has resulted in a renewed emphasis on agriculture and a redesign of some policies for increasing the economic opportunities for the rural poor. The revised National Budget Framework Paper for 2006/07–2008/09 puts forward a new Economic Development Strategy and Rural Development Strategy 'that is clearly focused on the needs of the household'.[29] A prominent part of this strategy is the launching of a 'sub-country development model':

> Initially, a model sub-County will be established in each district to demonstrate the enhancement of household incomes through increased production of appropriate commodities, their processing, value addition and marketing. Based on the agricultural zoning exercised carried out earlier a number of enterprises will be selected for Government support in each district. Government intervention will include the provision of improved seedling, extension services and support to value addition marketing and micro-finance. Existing Government initiatives will be redirected to support this model.30

While there is clearly a need to revisit the strategy and policies for promoting agricultural development, the philosophy behind the proposed 'sub-country development model' suggests a shift from a focus on creating a conducive environment for market driven development towards detailed micro-level state intervention. It would be unfortunate if this was to be applied as a main thrust of a new agricultural strategy and not just as a complement in the fringes. Such strategies, based on far-reaching and detailed state interventions have been tried and proven unsuccessful in the past. Even though the government will base the sub-county strategy on as non-distortive instruments as possible, there is still a problem of the advantages created for the pilot sub-counties which may give them a more or less long term possibility to reap the monopoly profits to the extent that the production is for the domestic market. Targeted interventions may have a demonstrative value, but this requires that others are able to copy the model on equal terms. Moreover, the model is likely to be administratively very expensive since there is always a fixed cost connected to the institutions that will manage the intervention, and the sustainability of this strategy can therefore be questioned given the capacity constraint of the government and the number of administrative units at the sub-county level. The model may partly be a response to the unavailability of data, and hence analysis, of the business

[29] MTEF (2006:2).

[30] MTEF (2006).

(farm or non-farm) constraint, resulting in a need to collect information at the micro level in order to understand why the poor has not been part of a growth driven by the real economy.

The revised National Budget Framework for 2006/07–2008/09 contains some major changes as compared to the original NBF for 2005/06–2008/09. The share allocated to 'economic functions and social services' has been substantially increased from 9.6 to 15.5 per cent of total expenditures, while the allocation to in particular health, but also agriculture, is being reduced (Table 5.3). Indeed, the increased policy focus on agriculture would seem to have given rather small imprint on the budget. The sharp decline in the allocation to health is ostensibly due to a reduction in project funding by donors in this field. Yet, when cast against the increasing rate of HIV/AIDS infection, it must give cause for concern.

As can be seen in Table 5.4 a major reason behind the shift is increased expenditures for 'energy and minerals' in response to the acute electricity crisis. The allocations for implementation of the 'sub-county development model' are relatively modest; 38 billion shillings or about 1 per cent of total expenditures under the MTEF, of which 29 billion are additional funding.

Table 5.3 Sectoral distribution of budget expenditures in the original 2005/06 and 2007/08 National Budget Framework (NBF) and in the revised 2006/07–2007/08 NBF. Percentages.

Sector	2005/06 Budget	2006/07 Original	2006/07 Revised	2007/08 Original	2007/08 Revised
Security	10.1	10.1	9.6	10.1	9.5
Roads and works	10.1	11.7	11.3	12.0	12.7
Agriculture	4.0	4.1	3.5	4.4	4.5
Education	17.1	18.3	18.3	18.1	19.0
Health	13.7	11.9	9.7	12.6	8.4
Water & sanitation	3.0	3.1	2.6	3.3	2.6
Law and order	4.9	4.9	4.8	4.8	4.9
Accountability	4.7	3.9	4.7	3.9	4.4
Economic functions and other social services	11.1	9.6	15.5	8.4	12.8
Public administration	13.6	12.4	13.0	12.3	13.1
Interest payments due	7.8	9.2	7.0	8.6	8.1
All sectors	100.0	100.0	100.0	100.0	100.0
Grand Total Ushs bn	3,716	3,783	3,878	3,933	3,956

Sources: MTEF (2005: Annex 2); MTEF (2006:46–47).

Table 5.4 Original a revised expenditure allocations for the subsector economic functions and other social services. Billion shillings.

Subsectors economic functions and other social services	2006/07 Original	2006/06 Revised
Energy and minerals	84.9	204.0
Tourism, trade and industry	58.6	43.8
Lands and environment	33.1	32.4
Gender, labour and social development	17.9	10.8
Office of the prime minister	50.7	88.3
Local government development	37.8	69.6
District functional literacy grant	2.0	1.6
District equalisation grant	2.3	3.5
Local government development programme	65.3	64.3
Non-sectoral conditional grants	6.9	8.6
Sub-county development grant	-	37.6
District women, youth, disability grant	1.9	1.4
District natural resource grant	1.4	1.1
Total economic functions and social services	364.8	602.3
Total MTEF	3782.9	3896.9

Sources: MTEF (2005: Annex 2); MTEF(2006:46–47).

By way of summing up, the dismal performance in terms of pro-poor growth and reduction of income poverty under the PEAP suggests a need to revisit the priorities and the design, thrust and forcefulness of the economic development policies. It is difficult to avoid the impression that past successes and an excessive belief that macroeconomic stabilisation and investment in human development will more or less automatically translate into pro-poor growth has diverted attention from the need to think through the challenges of putting Uganda on a path of sustainable pro-poor growth and poverty reduction. The present trend of stagnation in poverty reduction needs to be broken. As discussed above, this requires (i) addressing the issue of population growth, (ii) a rapid and sustained intensification of agriculture, and (iii) a diversification of the economy through the development of the non-farm sectors. It is important that the government focuses on general measures aimed at improving the business environment and creating conditions for efficient market-based development and that it refrains from attempts to replace a market-based development by detailed state interventions. Direct state interventions may have detrimental effects on productivity in case they are not just used as complements to and in support of a market-oriented, private sector-led growth. The establishment of peace and security and law and order in the entire country, prevention of the spread of HIV/AIDS and an empowerment of women, economically and otherwise, are other indispensable parts of such a strategy.

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