SUMMER 2010

DOMESTIC RESOURCE MOBILIZATION IN AFRICA

UGANDA

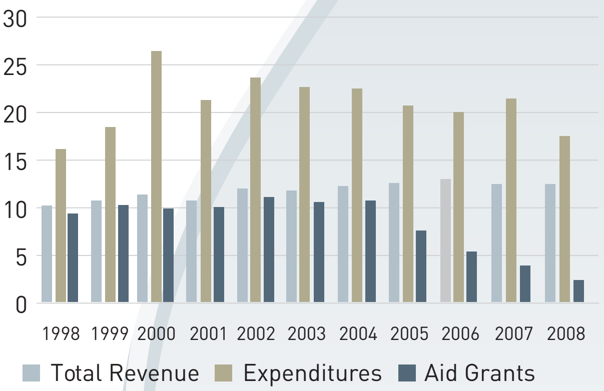
The project: The North-South Institute has been working with African, UK and Canadian partners on case studies exploring the potential for domestic resource mobilization (DRM) in five Sub-Saharan countries: Burundi, Cameroon, Ethiopia, Tanzania and Uganda. DRM refers to savings and investments that are generated by both the public sector (primarily through taxation) and the private sector (as a channel for private savings by households and domestic firms). Interest in DRM as a means to support sustainable growth and reduce dependence on external aid has been growing: in 2002, the Monterrey Consensus made improved DRM the first of its leading recommended actions; and, the current global economic crisis has only drawn more attention to DRM's potential, due to declining flows in external assistance and global remittances. This summary sets out our key project findings for Uganda.

Context: Ugandan economic growth outpaced the rest of Sub-Saharan Africa in the 1990s, reducing the proportion of the population living in poverty from 56% in the early 1990s to about 30% more recently. In 2008, GDP per capita stood at US$1,371 (PPP), far below the Sub-Saharan average of US$2,056 (PPP). Recent growth has been driven by the industrial and service sectors, yet the vast majority of the workforce (70%) remains self-employed, primarily in small-holder agriculture.

Significant gaps between government revenue and spending have been filled by aid and borrowing. These sources financed about 33% of the budget in 2008, although this is down from 72% in 1999 after substantial debt forgiveness. The government has introduced a strategy to further reduce reliance on external resources. This includes placing limits on external financing, favouring grants over loans, and prioritizing investment in infrastructure as well as tax reforms aimed at increasing domestically mobilized revenue.

Key constraints to DRM: Uganda's **savings rate** stagnated at less than 10% in the last decade, well below the Sub-Saharan average. Yet savings are important to Ugandans because of high income volatility, underdeveloped financial systems and lack of a social safety net. Such savings, however, are often in the form of non-financial assets or participation in small informal networks and are, therefore, unable to garner resources for long-term investment. Larger formal financial institutions are concentrated in urban areas. In the formal banking sector, weak competition, high overhead costs and poor credit information translate into wide spreads: borrowers pay as much as 24%, while savers earn only 4%. Long-term credit is hard to come by, with

Revenue, Expenditures and Aid Grants
(% GDP)



Source: Uganda Bureau of Statistics

Rank in Doing Business Database 2010:	112/183
Tax revenues (% GDP):	13.1*
Savings rate (% GDP): Sub-Saharan average:	7.5* 16.6 (2000-08)

*latest available figures

Sources: World Bank, Doing Business Database, 2010 and World Development Indicators Database; International Monetary Fund, International Financial Statistics

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only 12% of all bank loans maturing in more than one year. The agricultural sector particularly lacks access to credit.

Uganda's tax base is narrow, with the 35 biggest taxpayers accounting for about 50% of all tax revenue. The agricultural sector, which provides 15% of GDP, is untaxed. Outside the formal sector, much potential revenue is lost, owing to weak administration, corruption and tax evasion. Actual value added tax collections, for instance, were far less than what would be expected with statutory rates as high as 18%. Moreover, coverage of the already small tax-base is inadequate: it is estimated that only 5% of the value added tax on domestic commodities is actually collected. Despite implementing several reforms, the tax burden still falls disproportionately on that small segment of the population which is formally employed. Receipts from custom duties, on which the country depends, are also expected to fall as Uganda enters into the East African Customs Union.

The way forward: Further efforts are needed to **raise tax revenues** including bringing in a national identity card to facilitate tax collection. Introducing a property tax and better tapping into the potential of presumptive taxes in the informal sector should also be considered. Success in enhancing tax revenue mobilization, however, will ultimately depend on political leadership on the issue, which could begin with a comprehensive **review of the costs and benefits of existing tax incentives**.

Uganda is expected to benefit from oil revenues in the near future. Tax authorities will need to work with other stakeholders to best manage these for the benefit of all Ugandans. The presence of such revenues should not undermine other necessary DRM efforts.

Strengthening and deepening the financial sector should be a priority in Uganda. This requires both direct and indirect measures. To address challenges related to access to financial services, the government should continue to encourage savings and credit cooperatives and create incentives for formal financial institutions to reach beyond urban centers. Facilitating this requires building and improving basic infrastructure, such as roads and electricity.

Liberalizing the pension sector could help **fuel capital market development**. Establishing a dedicated agricultural bank, reinforcing land and corporate registries, strengthening the credit reference bureau, and other measures aimed at building long-term credit markets such as for mortgage finance, are further promising avenues for Uganda.

*This is a summary of **Domestic Resource Mobilization in Sub-Saharan Africa: The Case of Uganda** by John Mary Matovu of the Economic Policy Research Centre, Makerere University, in Uganda. To read the full case study, go to www.nsi-ins.ca and follow the research project links.*

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