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Uganda
UG-Economic Update

Ninth Edition: Infrastructure finance deficit: Can Public-private-partnerships fill the gap?

June 2017

MFM

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Infrastructure finance deficit: Can public-private partnerships fill the gap?

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Foreword

A key strategy that Government of Uganda has pursued over the past decade has been to increase the amount of resources allocated to capital investments in order to address a binding constraint on growth, the huge infrastructure deficit. That notwithstanding, Uganda's existing fiscal space has remained insufficient to meet its infrastructure needs, with an infrastructure financing gap estimated at US $ 0.4 billion per annum.

I am pleased to introduce the Ninth Uganda Economic Update, which discusses how Uganda can potentially nurture the public-private partnerships to address Uganda's infrastructure deficit. As is increasingly being experienced by many other countries across the world, these arrangements can help mobilize resources to help fill the infrastructure gaps, with a possibility of such arrangements bringing in private financing and facilitating the achievement of higher levels of efficiency in infrastructure investments. Yet, these arrangements may also carry risks, with a potential to drive significant deviations of the outcomes from their expectations. In line with the structure of earlier editions of the Uganda Economic Update, the report first discusses the general status of the economy, before discussing the PPP specific topic in greater depth.

At present, Uganda's rate of economic growth is at its lowest level for the past two decades, largely due to the impact of factors related to the upheavals in Uganda's banking system and to the ongoing impact of the drought on agriculture, the civil strife in South Sudan, and the increasingly volatile external environment. While the authorities continue to pursue an ambitious public investment program intended to address Uganda's long-standing physical infrastructure deficits and to prepare for the long-awaited extraction of oil, this program has not been implemented as fast as desired. In addition, so far, it has not been able to catalyze higher levels of private investment growth. Therefore, in the five-year period up to FY 2015/16, overall investments have been growing at the average annual rate of only 4.3 percent. At this rate, these investments have been able to generate only very modest overall economic growth. In the short-term future, economic growth also faces significant risks, including those from ongoing impact of the shocks that have constrained Uganda's growth in the recent past, and to those related to the suboptimal sequencing and management of the large infrastructure investment program. Moreover, with the limited fiscal space, financing of this program is a key risk.

To mitigate the financing risk, the Government ought to explore non-traditional approaches to large infrastructure financing. Public-private partnerships have the potential to provide the resources and also to facilitate the achievement of higher levels of efficiency and thereby to improve the quality of infrastructure assets and services and to ensure greater coverage. However, they also have limitations. Therefore, for Uganda to maximize the value of such public-private partnerships, it will have to draw on the lessons learnt while implementing these arrangements and from global best experience. These lessons underlie the importance of building sufficiently strong institutions to appropriately design and implement these partnerships.

I sincerely hope that this edition of the Uganda Economic Update will stimulate debate and motivate a comprehensive set of policy actions to champion more efficient management of investments implemented through public-private-partnerships, thereby promoting increased economic growth and supporting the achievement of Uganda's development objectives.

Diarietou Gaye

Country Director

Eritrea, Kenya, Rwanda, and Uganda; Africa Region

Abbreviations and Acronyms

BoU	Bank of Uganda
BOP	Balance of Payments
CBR	Central Bank Rate
CEM	Country Economic Memorandum
CNOOC	China National Offshore Oil Corporation
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
COMESA	Common Market for Eastern and Southern Africa
DRC	Democratic Republic of Congo
DSA	Debt Sustainability Analysis
EAC	East African Community
EU	European Union
FDI	Foreign Direct Investment
FY	Financial Year
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
IBP	Integrated Bank of Projects
ICT	Information and Communications Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
MFPED	Ministry of Finance, Planning and Economic Development
MDA	Ministries, Departments and Agencies
MoLG	Ministry of Local Government
MTEF	Medium Term Expenditure Framework
NBFP	National Budget Framework Paper
NCN	Non-Concessional Borrowing
NSSF	National Social Security Fund
RWA	Risk Weighted Assets
CCB	Capital Conservation Buffer
NDP	National Development Plan
NEER	Nominal Effective Exchange Rate
NPA	National Planning Authority
ODA	Official Development Assistance
OECD	Organization of Economic Cooperation and Development
OPM	Office of the Prime Minister
PAPP	Project Analysis and Public–Private Partnerships
PDU	Procurement and Disposal Unit
PFMA	Public Finance Management Act
PFM	Public Financial Management
PIMA	Public Investment Management Analysis
PIMAC	Public and Private Infrastructure Investment Management Centre
PIMI	Public Investment Management Index
PIMS	Public Investment Management System
PPDA	Public Procurement and Disposal of Public Assets Authority
PPP	Public-Private Partnerships
RAPs	Resettlement Action Plans
RDP	Reconstruction and Development Plan
REER	Real Effective Exchange Rate
SBFP	Sector Budget Framework papers
SMEs	Small and Medium-sized Enterprises
SSA	Sub-Saharan Africa
SWA	Sector Wide Approach
SWG	Sector Working Group
UEU	Uganda Economic Update
UBOS	Uganda Bureau of Statistics
UNHS	Uganda National Household Survey
UGX	Uganda Shillings
USA	United States of America
URA	Uganda Revenue Authority
UNRA	Uganda National Roads Authority
VAT	Value Added Tax
WB	World Bank
WDI	World Development Indicators

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Key Message

As a result of a number of internal and external shocks, Uganda's economy is currently growing at the lowest rate recorded over the past two decades. During the first half of FY 2016/17, the economy grew at the annualized rate of 2.6 percent, considerably lower than the long-term average rate recorded over the past two decades, which stands at around seven percent. The decline over the past five years is related partly to the increasingly volatile external environment and partly to domestic policy responses to shocks and strains related to the ongoing impact of the drought on agriculture, the civil strife in South Sudan, and the upheavals in the banking system. Therefore, current policy is focused on the management of these impacts so that they do not exacerbate macroeconomic instability and on measures to stimulate the economy to increase growth. The Government remains strongly committed to an investment push to accelerate and sustain high levels of economic growth and to facilitate socio-economic transformation.

The Government's investment push is intended to address binding constraints on growth, with the most significant of these constraints being Uganda's huge infrastructure deficit.[1] The Government has been further motivated to increase capital investment by the prospect of revenues from the exploitation of oil, which would create new opportunities to allocate additional resources to finance critical infrastructure and also to invest in human capital. With the Government aware that it cannot achieve these objectives entirely with its own resources, it has increasingly engaged in partnerships with the private sector. However, neither the expansionary fiscal strategy nor the implementation of public-private partnerships (PPP) can be justified unless these measures facilitate the achievement of the intended objectives, including higher rates of economic growth and increased domestic resources, which in turn could drive a more rapid process of development, including through increased human capital accumulation.

The first part of the Ninth Uganda Economic Update presents an assessment of the current state of the economy, while the second part addresses a specific theme related to Uganda's development challenges and the manner in which these may be addressed. This focusses on how the management of PPPs can support Uganda's investment push by facilitating access to private sector financing, by managing the risks intrinsic in these arrangements, and by maximizing the economic and social value of these partnerships. This can only be achieved if the Government is committed to building the appropriate set of frameworks to create a conducive environment for private investments and to adopting robust project identification, screening, procurement and contract management processes.

Part 1: State of the economy

Through the first nine months of FY 2016/17, the Ugandan economy continued to suffer from the negative impact of a number of internal and external shocks that have affected the country for several

[1] The World Bank's Systematic Country Diagnostic, 2015, also identified the infrastructure bottlenecks, particularly in the power and road sector, access to finance, low level of skills, and the administrative burden of taxes as the key constraints to growth.

years. In particular, in terms of external factors, Uganda's economy has continued to suffer from the increasingly uncertain global policy environment for trade and integration and the decline in commodity prices. Even though the policy frameworks held up well during the most recent election cycle in 2016, serious strains related to the macro instability resulting from the previous election cycle in 2011 have persisted, exacerbated by the stringent counter policy response, adverse weather conditions, civil unrest in South Sudan, and upheavals in the financial system. Uganda's economic policy makers have focused on managing the impact of these shocks, while at the same time attempting to seize opportunities to stimulate the economy to achieve higher rates of economic growth.

By the end of December 2016, at the midpoint of FY 2016/17, the annualized economic growth rate stood at only 2.6 percent. This is considerably lower than the figure of 5.9 percent recorded for the same period in the previous year, continuing the downward trajectory that has persisted for several years. Due to the prolonged drought conditions, the agricultural sector recorded a negative growth rate of -2.2 percent during the first half of this year. The services sector, which has been Uganda's principal driver of growth in recent years, grew by 4.4 percent. With the manufacturing and trading sectors starting to recover from the disruptions to Uganda's main market in South Sudan, the growth of the industrial sector was mainly driven by an increase in construction activities, largely due to government projects. As a result, this sector grew by the annualized rate of 3.4 percent in the first half of the year.

Over the first eleven months of FY 2016/17, average annualized inflation stood at 5.6 percent, despite the impact of the prolonged drought on food prices and other inflationary pressures. This low rate of inflation justified an easing of monetary policies by the Central Bank. While this policy action was partly intended to increase the availability of credit to the private sector, its impact was delayed and limited. Firstly, commercial banks reduced their lending rates only marginally, from 23.5 percent in June 2016 to 23.1 percent in February 2017, before a more substantial reduction to 20.5 percent by April 2017. Secondly, commercial banks had introduced more stringent borrowing conditions in response to the increasing deterioration in the quality of credit that commenced in the previous year. In addition, because of Uganda's limited financial depth, even disregarding the limited impact on interest rates, these policy actions have had only a limited impact on economic activity, with the proportion of the private sector having access to commercial loans remaining low.

These developments had a significant impact on access to funding from domestic banks and from external sources, with the rate of growth of credit to the private sector failing to register tangible improvement through the year. While the rate of growth of credit to the private sector had registered a negative annual growth rate of -1.1 percent by the end of September 2016, it had since begun to gradually recover, increasing to an average rate of growth of 5.2 percent during the subsequent quarter ending December 2016, and to 6.2 percent during the quarter ended March 2017. With the value of the shilling not very stable in the recent past, the domestic commercial banks have increased recognition of foreign exchange risks, which has deterred agents from borrowing in dollars, given that the bulk of these agents were engaged in activities that generate revenues denominated in the local currency, thus leaving them considerably exposed to risks related to depreciations in the value of the currency. The value of loans denominated in foreign currency declined from an equivalent of US $ 1463 million recorded in June 2016 to US $ 1391 million. The value of funding received by the private sector from

external sources was limited, as the bulk of the increase in the value of these flows during the first half of the year consisted of reinvested earnings. The total value of foreign direct investments amounted to US$ 426 million during the first half of FY 2016/17, compared to the figure of US$ 269 million recorded in the corresponding period of FY 2015/16. Out of this, the value of new direct equity investments was US$155 million for FY 2015/16 and US$ 101 million for FY 2016/17. In addition, the value of export of goods and services during the first quarter of FY 2016/17 was lower than average, although there was a recovery during the second quarter due to increased demand, with Uganda penetrating new markets in Asia. Under these circumstances, the value of private investments is estimated to be slightly higher than the figure recorded in the corresponding period of FY 2015/16.

Uganda's external position has remained weak during the first half of FY 2016/17, with the impressive performance in terms of reducing the current account being more than offset by the decline in the value of long-term capital and finance inflows. The combined effect of the reduced cost of imports (especially oil) and the increase in exports reduced the merchandise trade deficit. Even though the balances on services and income declined, the current deficit stood at 5.1 percent of GDP by the end of December 2016, significantly lower than the figure of 7.4 percent recorded in the previous year. However, with the decline in the strength of capital and financial flows, a deficit in the overall balance of payments to a value of US$ 318.6 million was recorded by the end of December 2016, reversing the surplus of US$ 390 million recorded in the previous year.

During the second half of FY 2016/17, a number of areas in Uganda's external position improved, with this allowing Bank of Uganda to rebuild foreign exchange reserves. With stronger inflows related to services and income transactions, the deficit on the current account has been projected to decline further to a value equivalent to 4.8 percent of GDP by end of June 2017. And with stronger disbursements of long term loans, particularly the non-concessional loans financing large infrastructure projects, the overall balance of payments has been projected to have registered a surplus, amounting to US $ 232 million, with this surplus allowing the Bank of Uganda to increase foreign exchange reserves to a value sufficient to cover 5 months of import of goods and services by end of June 2017.

The execution of fiscal policy continues to be undermined by poor revenue collection performance, over spending in the recurrent budget and under-execution of the development budget. In the context of the slowdown in economic activity and the disruptions to trade during the first part of the year, Uganda recorded a significant shortfall in revenue collections, of about 2.5 percent relative to the targeted level. The overall value of collected revenues is projected to stand at 13.3 percent of GDP by the end of the financial year, compared to the budgeted level of 13.5 percent. The largest challenge to fiscal policy management remain the significant under-execution of the development budget, which is expected to remain below the target levels established in the approved budget by over three percentage points of GDP. The rate of execution of public investments was not good, especially for the projects funded by external partners, with 34 percent of the budget being absorbed during these months. Therefore, even though there was over expenditure in the recurrent budget, largely due to expenditure to meet salaries for non-teaching staff in tertiary institutions and to manage other emergencies, total expenditure is expected to reach 18.6 percent of GDP, well below the level of 22.5

percent of GDP targeted in the budget. The nominal value of the overall deficit is expected to be about UGX 3,500 billion lower than the projected level, leaving the fiscal deficit at only 3.5 percent of GDP. This would be almost 3 percentage points lower than the level targeted in the approved budget. About 77 percent of the deficit will be funded through external borrowing.

In spite of the stimulus effect of monetary expansion and some improvements in externally financed investments, recovery in private liquidity has been slow. As a result, the GDP growth rate during FY 2016/17 is estimated to remain below 4 percent, almost two percentage point lower than the authorities' forecast. The estimated growth rate is also about half a percentage point lower than the forecast in the previous World Bank Economic Update. This failure to achieve the forecast levels is primarily the result of the stronger than anticipated impact of macroeconomic shocks on private sector activities and failure to achieve execution of public investments as planned during the year. Nonetheless, the main driver of growth has been public investments, although this represents a smaller share of the economy than services, which account for close to half.

The economic growth rate is forecast to increase to 5.2 percent in FY 2017/18, and to 6.0 percent in FY 2018/19, predicated on improved weather conditions, ongoing improvements to the banking system, and improvements to the execution of public investment projects. Global economic uncertainties will continue to affect economic activity in Uganda into the midterm future. However, in the context of weak global economic performance, Uganda's economy will benefit from the low energy prices, particularly if investors take advantage of the associated low cost of imported inputs. The lifting of the 'new lending freeze' by the World Bank will play a role in building confidence in the economy. However, growth is expected to be primarily driven by public investments, with private investment still constrained by low levels of business confidence, the ongoing strife in South Sudan, and the high cost of credit. On the other hand, FDI in the extractives sector is expected to increase, following the issuance of long-awaited exploration agreements, increased efforts by the Government to develop oil-related infrastructure, and the signing of the agreement between Uganda and Tanzania for the construction of the oil pipeline East African Crude Oil Pipeline Inter-Governmental Agreement (EACOPIGA) for exporting oil between Hoima and Tanga port. The construction and services sectors are expected to continue to be the main drivers of growth. The stimulus effects from Uganda's large public investment program will offset negative effects of the weak external sector on the Ugandan economy.

The authorities must maintain a delicate balance between leveraging fiscal policy to stimulate economic activity while at the same time ensuring the shocks do not transmit into macro policy slippages. Following the completion of two large hydroelectric power projects and key transport infrastructure projects including those in the oil region, the fiscal deficit is expected to decline to below five percent of GDP in the medium term. The present value of public debt to GDP ratio stands at about 36 percent, well below the threshold of 50 percent for moderate performers like Uganda. An uncertain regional and global outlook will continue to have a negative impact on exports, remittances and foreign direct investments. With the need for imported inputs for infrastructure projects, the current account deficit will widen to between 8 and 10 percent of GDP.

Accelerated growth should facilitate a further reduction in poverty, with the poverty rate forecast to decline by an estimated 0.9 percentage points per year in the period from 2016 to 2019. At this rate, it is expected to reach 28.8 percent by FY 2019/20, with most of the decline being recorded in the Central and Western regions, thus widening regional spatial disparities. As of 2013, the poverty rate stood at close to 43.7 percent in the Northern region and 24.5 percent in the Eastern region, compared to 8.7 percent in the Western region and 4.7 percent in the Central region.

Despite the generally favorable outlook, the growth outlook is subject to a number of risks. These risks relate to the low revenue base, which is being further threatened by a renewed tendency for the Government to grant tax exemptions; the suboptimal sequencing, financing and management of the large infrastructure investment program; an increase in the debt to GDP ratio beyond the level of 50 percent if investments do not generate sufficient growth and revenues to service the growing debt; and to exogenous conditions, such as bad weather, regional instability, and the protracted low growth of the global economy. Additional risks relate to the potential for a disorderly election aftermath in Kenya, which could have an impact on regional trade, and to ongoing global economic uncertainty, which could have an impact on exports, remittances and FDI. Finally, the high cost of and limited access to credit and financial services are major constraints on Uganda's ability to achieve higher levels of productivity and diversification and to develop resilience to internal and external shocks.

Specific to Uganda's investment driven growth agenda is the risk to the financing of public investments. The Government's rapidly expanding infrastructure development program must be appropriately managed and sequenced to avoid unnecessary hike in financing risks. Still, the total value of the investments required to support Uganda's transformation is significant and it is unlikely that that existing fiscal space would be sufficient finance this need. This calls for the Government to tap into non-traditional approaches to alleviate the infrastructure financing gap. Among other means, the Government ought to unleash the power in public-private partnerships.

Part 2: Public-Private Partnerships: A Potential Means to Mobilize Uganda's Infrastructure Finance

Uganda has pursued an investment-driven growth strategy to accelerate growth and to enable the structural transformation of the economy. Over the past decade, the Government has implemented reforms to improve the investment climate for the private sector and adopted an expansionary fiscal policy to address binding constraints to growth. At the same time, the Government has increasingly sought to leverage private resources to enable it to close financing gaps and to achieve higher levels of efficiency. Regardless of the modalities adopted by the Government, it is critically important that these increased investments result in the creation and effective utilization of the productive assets needed to support accelerated economic growth rates and structural transformation.

Infrastructure needs in Uganda are vast, and Government resources required to meet these needs are insufficient. Addressing Uganda's infrastructure deficit would require sustained investment of almost US$ 1.4 billion per year in the medium-term to meet the gap. Uganda's budget is under strain with a

fiscal deficit that had been planned to increase to 6.5 percent of GDP in the next two years, before it starts declining. In FY 2017/18, total expenditure on infrastructure has been anticipated to reach the value above seven percent of GDP, yet is still below the level required to close the infrastructure gap.

While Uganda's existing fiscal space is insufficient to meet its infrastructure needs, it has been losing sizable amount of resources through inefficiencies. It has been estimated that Uganda has lost about US$ 300 million per annum in inefficient infrastructure spending mostly through underpricing in the power sector. Other inefficiencies observed include the inability to complete projects within cost and on schedule.

With insufficient fiscal space and inefficiencies constraining Uganda to meet its infrastructure development objectives, public-private partnerships (PPPs) can help fill some of these gaps. A PPP entails a long-term contract between a private party and a government entity to provide a public service with the transfer of substantial risk to the private party. PPPs may involve new or existing assets, with certain designated responsibilities assigned to the private partner. The private party recovers its investments through user fees, government payments or a combination of both. PPPs can help governments overcome budget constraints in two ways: through bringing in upfront private financing for capital investment with deferred government payments spread over project life and through wholly additional sources of funding for infrastructure where user charges can be levied, such as in toll roads or power projects. Middle income countries like Malaysia, Colombia, China, Brazil, Mexico, and Turkey are increasingly reliant on PPPs to finance their infrastructure projects.

PPPs can draw private financing and can also facilitate the achievement of higher levels of efficiency, thus improving the quality of infrastructure assets and services. PPPs can support the much-needed crowding in of private sector investment, while at the same time assisting the Government to achieve its development objectives through improved use of assets and better service coverage and quality. If structured and implemented appropriately, PPPs can also facilitate better risk management and include incentives to develop innovative approaches to output delivery. The provision of consistently high-quality services can be incentivized through the inclusion of performance and payment mechanisms into the agreement between the parties.

However, PPPs come with a host of limitations, which may lead to failure in the achievement of the key goal of increasing fiscal space. For example, in availability payments based PPPs, the government pays for the infrastructure. Even where users are charged for services, governments often have to bear the demand, forex, interest rate and inflation risks, creating contingent liabilities for the government. Contingent liabilities are hard to estimate and government may end up bearing more risk than they can effectively manage. Since PPPs involve fiscal risks that may result in outcomes differing greatly from the forecasts or expectations, it is important to have clear frameworks to assess these risks.

In addition, many of the benefits of PPPs depend upon the government's commitment to building the appropriate frameworks and institutions to provide a conducive environment for private investment, and its ability to effectively use these frameworks to procure and manage PPPs. The government needs to adopt robust project identification, screening, procurement and contract management processes. With the complexity of the PPP process, it is necessary to devote significant resources to the development of frameworks for PPPs management to ensure that they facilitate the achievement of the

intended objectives. Therefore, in order to undertake a structured PPP program, Uganda needs to build its institutions and skills. Uganda has embarked on this path by formulating a PPP Policy Framework, backed by the PPP Act of 2015.

PPPs can only be successful to the degree to which they can attract long term financing. PPP projects require significant upfront capital investment, often with back-ended revenue profiles resulting in the need for longer contracts of duration 20 years or more. The availability of long-term financing is extremely limited in Uganda. Neither the commercial banks nor Uganda's single development bank have been able to play an active role in providing long-term finance for the country's development needs. Lines of credit have been provided to select banks by development institutions, but these can only be viewed as temporary solutions. Thus, more sustainable sources need to be developed.

The pension sector represents the largest pool of long-term domestic capital in Uganda. Thus, its role in supporting the provision of long-term finance needs to be enhanced. It is hoped that the proposed reforms to the pension sector to support competition and growth will play a key role in catalyzing the growth of long-term finance in Uganda. The National Social Security Fund (NSSF) is the largest investor in Uganda, holding assets to a total value of UGX 6.5 trillion, or about 85 percent of the market. However, the existing level of domestic supply of financial instruments is insufficient for NSSF and other pension fund to invest in.

Capital markets in Uganda are not yet sufficiently developed to be able to supply the long-term resources required to promote higher rates of economic growth. To stimulate a more rapid development of the capital market, the Capital Markets Authority (CMA) has formulated a Capital Markets Development Masterplan. Domestic currency financing is limited and financing for PPPs will require Uganda to work towards appropriate de-risking of projects in order to attract equity and debt financiers. Consequently, to provide greater comfort to investors, it will be important for Uganda to develop robust processes for managing contingent liabilities arising out of PPPs at project and aggregate levels, and providing sources of liquidity to meet any potential payments should these liabilities be called.

In the context of the very limited supply of long term resources, the capital market, which is the main intermediary for long term finance, has remained shallow. The stock exchange has a market capitalization of 5 percent of GDP, compared to 50 percent in neighboring Kenya. The Capital Markets Development Masterplan proposes a number of key reforms that may transform the capital markets landscape in Uganda. These reforms include a review of fiscal barriers to capital markets development, the implementation of government bond market reforms as a precursor to the development of corporate bond markets, a widening of the investor base, the revision and amendment of the legal and regulatory framework for capital markets to ease issuance of securities, and measures to make the market infrastructure more cost-effective. All of these reforms can be expected to have a significant positive impact and should be implemented as a matter of priority.

Uganda can draw on the lessons learnt from its experience with previous PPPs. With investments in 24 projects with a total value of US$1,830.69 million, Uganda's share of all PPP projects in the sub-Saharan African region amounts to 8.3 percent. The largest sector in terms of PPI is the energy sector. The

majority of the financing for these projects has been through debt raised by the private entity, backed by guarantees provided by the Government. In other cases, they have involved direct government borrowing from bilateral and multi-lateral financing institutions. Uganda has had a mixed record in the implementation of PPPs, with moderately positive outcomes in the energy sector. In the transport sector, the first PPP arrangement for the Uganda-Kenya railways, involving Rift Valley Railways, did not yield satisfactory outcomes. Currently, the government is preparing to bring the Kampala- Jinja Expressway project to the market. The PPP Policy Framework to provide the legal framework for PPPs was adopted by Uganda in 2010, with the PPP Act being approved in 2015.

While Uganda has strong regulatory frameworks, actual implementation of these frameworks remains sub optimal. The promulgation of the PPP Act in 2015 placed Uganda in the same league as South Africa and Kenya in terms of the legal frameworks required to support PPPs. However, these frameworks need to actually be implemented for Uganda to conform to global good practice for the management of PPPs. There is a lack of institutions, human resources and well-laid out processes and methodologies to implement the framework with the result that the PPP program has been slow to take off with little experience in PPPs other than in the energy sector. To maximize the value derived from its investments through PPPs and to manage the associated risks, Uganda needs to immediately establish the appropriate institutions and processes to actualize the existing policy frameworks.

The lessons from experience in Uganda and global best practice emphasize a number of aspects that must underpin a successful implementation of PPPs. These include ensuring that the selection of projects to be done well; the allocation of sufficient resources for the project preparation; the adherence to open, transparent and competitive processes; the use of clear processes for determining public support; the ensuring existence of capacity across all government officials, and the existence of sound institutional and regulatory frameworks. Uganda ought to take action in six major areas in order to achieve a more robust and better structured longer term PPP program that can guarantee improved outcomes from PPPs:

(i) **To maximize the value derived from its investments through PPPs and to manage the associated risks, Uganda needs to immediately establish the appropriate institutions to actualize the existing legal and policy frameworks**. This entails creating capacity within the central PPP unit and the potential contracting authorities to enable them to prepare, appraise and provide oversight for PPP projects. The PPP screening process must be imbedded and well-coordinated with the overall Public Investment Management (PIM) process so that only economically feasible investments that show promise as PPPs are taken up for further detailed studies. It also requires establishing methodologies for detailed feasibility analyses, including value for money assessments and fiscal affordability assessments; streamlining the procurement processes, including adding greater detail and competition into the process for unsolicited projects; establishing robust contract management processes; and establishing robust fiscal risks assessment both at the national level and at the project level.

(ii) **Uganda's PPP program needs to be appropriately resourced to enable it to provide stronger leadership and direction, and for funding project preparation, providing viability support and a liquidity reserve to backstop any contingent liabilities.** The Government of Uganda needs to urgently set up the Project Development Facilitation Fund. This will entail mobilizing budgetary and non-budgetary resources, including from bilateral and multi-lateral donors. Revenue flows from projects, including success fees, can be other sources of revenue for such fund. It will also entail setting up the governance and operational framework for the functioning of the fund.

(iii) **Uganda should work towards building a robust PPP pipeline**. There are several project ideas especially in the road, energy, residential and commercial accommodation and other sectors which should be screened from the investment and PPP perspectives. It is essential to move these projects forward, including through the development of a sustained project development funding mechanism in the form of the PDFF and to tie these projects to efforts on developing innovative financing mechanisms.

(iv) **Uganda should incorporate the principles of transparency and accountability into its PPPs programs to allow better citizen engagement and involvement in decision-making.** Key information related to both operational and pipeline projects at various stages of preparation and procurement should be placed in the public domain in a timely manner to increase the predictability of Uganda's PPP program. Public scrutiny is likely to incentivize government to adopt transparent and accountable processes, consequently stimulating investor interest and stakeholder support for PPP as a modality of asset creation, operation and management, and efficient and effective service delivery. Therefore, a communication strategy should be developed for the PPP program to sensitize both internal and external stakeholders and to engage them in dialogue through a higher level of stakeholder engagement and better disclosure policies. A structured communications program would ensure that prospective investors, contracting authorities and the general public are aware of the salient features of the PPP Act and the processes to be followed for projects, including processes related to procurement. It would also ensure that the Government's pipeline and priority areas for PPP are fully visible.

(v) **The creation of a PPP database should be expedited to disclose key information related to both operational and pipeline projects at various stages of preparation and procurement.** This would increase the predictability of pipeline projects and promote transparent and accountable processes, consequently stimulating investor interest and stakeholder support for PPP as a modality for asset creation, operation and management, and efficient and effective service delivery.

(vi) **The use of innovative means to mobilize domestic resources should be adopted as the development of the domestic financial markets is expedited in order to reduce the financing risk for PPPs.** For countries such as Uganda, where the domestic financial markets

and capital markets are still limited, financing for PPPs and options for credit enhancement are biased towards foreign sources, which in turn makes the foreign currency exposure a key risk for investors. As the Government expedites the development of the pension sector and implements the Capital Markets Master Plan, it should also make efforts to mobilize domestic currency financing through the establishment of syndicates of commercial banks and large surplus institutions such as pension funds, particularly the NSSF, to finance PPPs. Innovative mechanisms such as infrastructure debt funds can also be formed.

Part 1: State of the Ugandan Economy

- By the end of December 2016, Uganda's economy was growing at the annualized rate of 2.6 percent, compared to 5.8 percent for the corresponding year ending December 2015; this deceleration is the result of the ongoing impact of the prolonged drought, to a slow recovery in the provision of credit to the private sector by the banking system, and to disruptions to trade with South Sudan.

- Despite the impact of the drought on food prices, the inflation rate has remained moderate. This enabled the authorities to continue to ease their monetary policy stance, the effect of which gradually became manifest, with the commercial banks slowly reducing lending rates and accelerating the rate of expansion of credit to the private sector and money supply during the six months to March 2017.

- Uganda's external current account deficit eased to a value equivalent to 5.3 percent of GDP by the end of December 2016, with the import bill being contained by low oil prices and exports increasing due to the advent of refined gold exports and to the penetration of new markets in South Asia. However, the overall external position remained weak due to the failure to attract higher capital inflows.

- On account of the huge under-execution of the budget during FY 2016/17, the fiscal deficit is expected to reach only 3.5 percent of GDP, far lower than the budget of 6 percent of GDP. With nearly 77 percent of this deficit funded externally, the crowding out effect on the private sector is relatively insignificant.

- The economy will grow at a rate below 4 percent this year, with this rate increasing to around 5-6 percent in FY2017/18 and FY 2018/19, predicated on the effect of the drought receding, the containment of the level of troubled assets within the banking sector, and improvements to the execution of public projects.

- With the performance of the private sector remaining subdued due to the ongoing impact of internal and external shocks public investments will remain the key driver of growth, with their effect boosting the construction sector in particular. The services sector is still the most significant contributor to total value added in the economy.

- With continued volatility posing challenges to long term finance and the financing of investments in Uganda, the Government needs to ensure that its investment program is soundly financed and generates real productivity improvements. To achieve this, the Government must address the deficiencies within the domestic financial system, explore the use of blended financing options and intensify efforts to tap into private sector capabilities through efficiently managing private public partnerships.

1. Recent economic Developments

In FY 2016/17, economic activity was much more subdued than had been anticipated, continuing a trend that has persisted for the last five years. By the end of the first half of the year, the Ugandan economy was growing at an annualized rate of 2.6 percent. This sluggish performance started to show signs of improvement during the fourth quarter of the year. Commercial banks started to reduce interest rates and to increase their lending to the private sector, albeit at a very slow rate. However, a combination of bad weather conditions, the poor quality of credit, disruptions to trade with South Sudan, and low global demand continue to constrain private investments. On account of this, activity in the agricultural and manufacturing sectors has remained sluggish. Implementation of the public sector's investment program failed to meet target, with this mainly on account of low performance of externally funded projects. Nonetheless, the construction and the services sectors remain the key drivers of growth.

Combined with Uganda's rapid population growth rate, the recent decline in its GDP growth rate has resulted in Uganda recording a far less impressive increase in average per capita income than its regional peers. In the period from FY 2011/12 to 2015/16, the average annual GDP growth rate stood at 4.5 percent, considerably lower than the long-term average (currently 6 percent), and even lower than the average figure of seven percent recorded in the immediate post-reform period, from the 1990s to the early 2000s. At the same time, Uganda's population growth rate has remained high, with this rate standing at 3.0 percent per annum according to the most recent population census conducted in 2014. Therefore, by FY 2015/16, Uganda's average annual per capita income was estimated to stand at US$ 690, far lower than the average figure for developing countries in the sub-Saharan African region, which stands at around US$ 1,638. A range of external shocks over the past few years, including those related to the global economic and financial crisis, low commodity prices, civil unrest in neighboring South Sudan, the poor quality of and limited access to credit in the domestic banking system and the recurrent drought conditions across Uganda, have contributed to the deceleration in growth. In addition, constraints related to inadequate, high-cost infrastructure and inefficient financial intermediation have continued to exert a dampening effect on economic growth.

The difference between Uganda and its peers can be explained by the difference between the drivers of growth in their respective economies. As in the case of Kenya and Tanzania, Uganda's economy is not currently dependent on oil exports. Thus, it has escaped the severe slowdown that has characterized the economies of Nigeria, Angola, and the Central African Economic and Monetary Community (CEMAC) countries. However, as a landlocked country, it has not benefited from increased openness to the same degree as the other two East African Community (EAC) neighbor countries. The second source of difference is the rate at which these countries have reaped a dividend from their public investment programs. Like other landlocked countries in the region, such as Ethiopia and Rwanda, Uganda is engaged in a public investment drive that is focused on the development of infrastructure. However, these peer countries have been able to generate a stronger growth impact than Uganda due to the former countries' high rate of execution of their investment programs. Finally, Uganda's economy has been negatively affected by civil strife and political turmoil in three neighboring countries, South Sudan, DRC, and Burundi, making it difficult for the Great Lakes region as a whole to gain economic traction.

While it is estimated that Uganda's poverty rate continued to decline in FY 2015/16, the ongoing economic deceleration has serious negative implications given the high level of vulnerability to poverty in the country. The proportion of households living below the international poverty line, which stands at US$ 1.9 per day in 2011 purchasing power parity terms, is estimated to have declined to about 31.8 percent in FY 2015/16. This is almost 10 percentage points lower than the figure of 41.5 percent recorded five years ago[2]. However, more than 43 percent of the population live just above the

[2] Using the National poverty line, which is slightly less than a dollar, this ratio is estimated to have declined from the figure of 24.5 percent recorded in 2009/10, to about 19.7 percent in FY 2015/16.

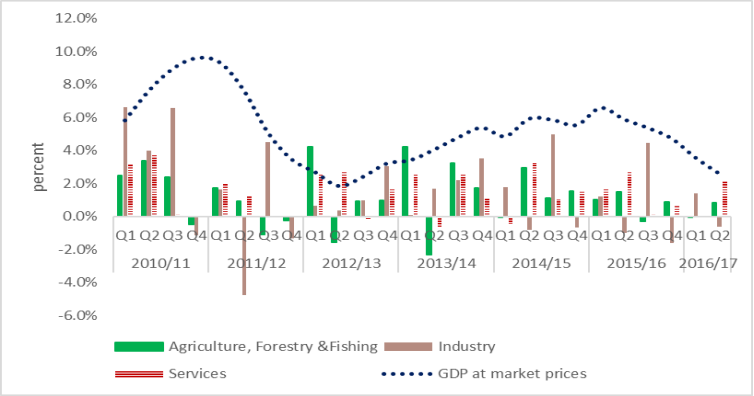
poverty line, and are thus highly vulnerable to the risk of falling back into poverty in the case of economic shocks. This vulnerability is particularly pronounced given that the agricultural sector has contributed to more than 79 percent of the decline in poverty over the past decade, with the agricultural sector remaining undeveloped and highly vulnerable to shocks, particularly shocks related to the unpredictable weather. While the structure of the economy is slowly undergoing a process of transformation, approximately three-quarters of the population still depend primarily on low paying jobs in the agricultural sector. Of this portion, the majority are still employed in subsistence farming, which contributes to approximately 25 percent of the total value of GDP.

1.1 Economic activity in FY 2016/17: Has been subdued

During the first half of FY 2016/17, due to the impact of the economic shocks described above, Uganda's economic growth was particularly subdued. By the end of December 2016, at the midpoint of FY 2016/17, overall economic activity was increasing at the meagre annualized rate of only 2.6 percent,[3] compared to the rate of 5.8 percent recorded for the year ending December 2015. This growth is also considerably lower than the rate recorded for the previous financial year FY 2015/16 as a whole, which stood at 4.7 percent. It is also dramatically lower than the rate the authorities had forecast in the budget, with the rate for this period originally projected at 5.5 to 6.8 percent. Thus, the economy has continued on a downward trajectory that has persisted for several years, with many analysts' expectations of a recovery in the post-election period having failed to be realized. Even though the policy frameworks held up well during the most recent election cycle in 2016, after-effects from the previous election cycle in 2011 persisted, including diminishing levels of donor budget support and tighter spending controls. On top of these semi-structural factors, the economy has been negatively impacted by adverse weather conditions, attacks on traders and disruptions to the trading routes between Uganda and South Sudan, concerns regarding the social impacts of various projects, and upheavals in the banking system. Therefore, the effect of an almost year-long easing of the monetary policy stance to stimulate the economy has had only a very limited impact, largely failing to stimulate sufficient private sector credit uptake.

In the context of these internal and external shocks, the rate of growth of both private and public investments has decelerated significantly, with economic growth mostly driven by consumption. By the end of December 2016, the total value of new investments had declined to almost half the value recorded in the previous year. In terms of public investments, the total value declined from UGX 2,948 billion to UGX 1,424 billion. While the value of private investments declined from UGX 16,983 billion to UGX 8,525 billion over the same time period.

Figure 1: Quarterly Real GDP growth volatile and on a declining trend recently



Source: Uganda Bureau of Statistics

[3] Annualized growth rate has been calculated as the most recent four quarters, compared to the corresponding period of the previous year.

While the growth rate for all sectors of Uganda's economy decelerated, the services sector continued to be the main driver of economic growth. At present, the services sector accounts for 51 percent of the total value added to the economy. For the six months to December 2016, activity generated within this sector increased by 3.4 percent, relative to the level of activity in the corresponding period of 2015. Within the services sector, growth was driven mainly by the information and telecommunications, real estate, social services (including both health and education) and public administration sub-sectors. Growth in the financial services sub-sector decelerated, with increases in the level of non-performing assets and a reluctance on the part of the banking system to extend credit. Growth in the trade and repair services sub-sector also decelerated, largely due to the ongoing negative effect of the conflict in the South Sudan. A deceleration in the growth of the services sector could have significant negative implications for poverty and employment picture, given the increasing number of people employed in this sector, as experience in other developing regions indicates (Ghani and Kharas, 2010)[4]. By the end of FY 2012/13, 82 percent of Ugandan workers outside the agricultural sector were self-employed, mainly in the services sector, a dramatic increase from the figure of 40 percent recorded in FY 1992/93.

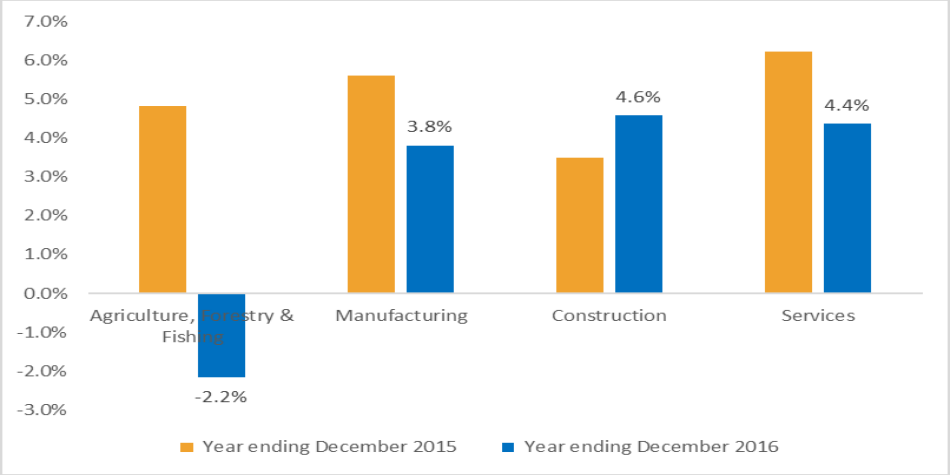
In the industrial sector,[5] the volume of activity in the first half of the current fiscal year was 3.4 percent greater than the volume realized in the corresponding period of the previous year. This growth was mainly driven by the manufacturing and construction sub-sectors, which grew strongly, at the rates of 5.8 percent and 3.0 percent respectively. Operators within the manufacturing sub-sector, including those involved in food processing and the production of industrial materials, started to recover from the effects of the trade disruptions between Uganda and South Sudan. In particular, these operators have benefitted from the lower prices of imported inputs, while the growth of the construction sub-sector has mainly been driven by increased public investment in infrastructure. The growth rate for the mining and quarrying sub-sector[6] declined strongly, although this subsector still makes only a relatively insignificant contribution to total GDP, and thus this decline had only a limited impact on the overall economy.

[4] Ghani, Ejaz, and Homi Kharas. 2010. "The Service Revolution in South Asia: An Overview." In the Service Revolution in South Asia, ed. E. Ghani, 1–32. New York: Oxford University Press.

[5] 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.

[6] Mining and quarrying does not include oil activities. These are currently captured under construction.

Figure 2: Construction and Services: The main drivers of economic growth



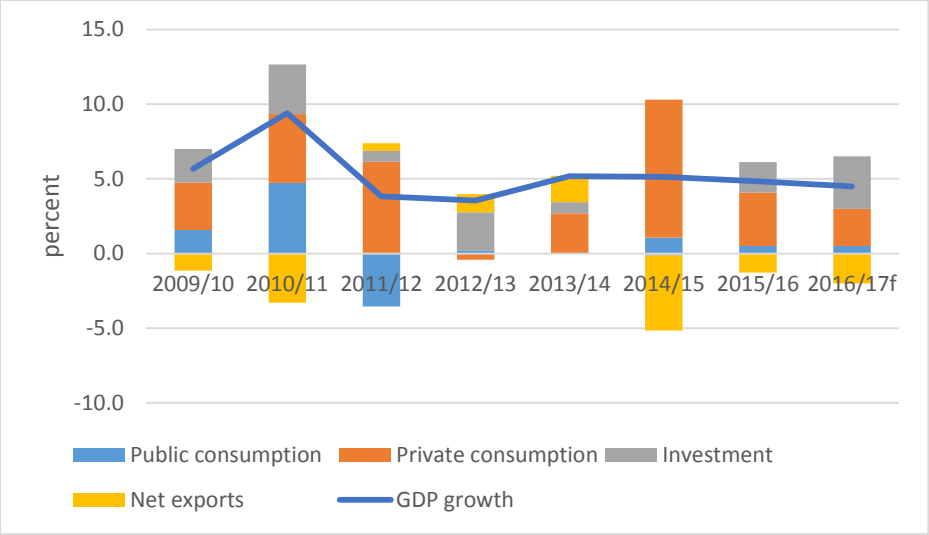
Source: Uganda Bureau of Statistics, 2012 and World Bank Staff Estimates

The agricultural sector continued to perform poorly as a result of the harsh and unpredictable weather conditions related to the *el nino* and *la nina* weather phenomena. During the first half of FY 2016/17, the total value of activity in this sector was 4.5 percent lower than the value recorded in the corresponding period of 2015/16, continuing the downward trajectory that commenced in the previous half-year. The output of crops declined most severely (by almost eight percent), with this decline having a significant impact on the welfare of the poor. Despite the provision of aid by a number of development partners, a significant proportion of the population in a number of districts are facing hunger and starvation. An increasingly unpredictable and drought-prone climate; increased pest attacks[7]; limited investment in irrigation; soil depletion resulting from limited fertilizer usage; and rising population pressures are exacerbating the challenges faced by the agricultural sector.

The authorities have implemented fiscal and monetary policies to manage the impact of these shocks. Public expenditure, particularly on capital development, has been increasing steadily since FY 2011/12, following the Government's adjustments to budget policies in an effort to stimulate growth. As a result of these policies, the average annual value of public investments increased from 5.7 percent of GDP in FY 2011/12 to 8.5 percent in FY 2015/16, with this figure originally projected to reach 9.8 percent in FY 2016/17 budget. However, both private investment and consumption have increased at lower rates, partly because of the challenges faced by the financial system, and the low execution and limited spillover from public projects. The total value of private investments declined from the average share of 21.3 percent of GDP between FY 2011/12 and FY 2012/13, to 16.3 percent in FY 2015/16. This figure is expected to decrease further to about 16.1 percent of GDP, in the current financial year.

[7] During this financial year, a number of districts have recorded losses in output on account of the army worm attacks on particularly grains, but also seen to spread to other crops

Figure 3: Contributions to annual GDP

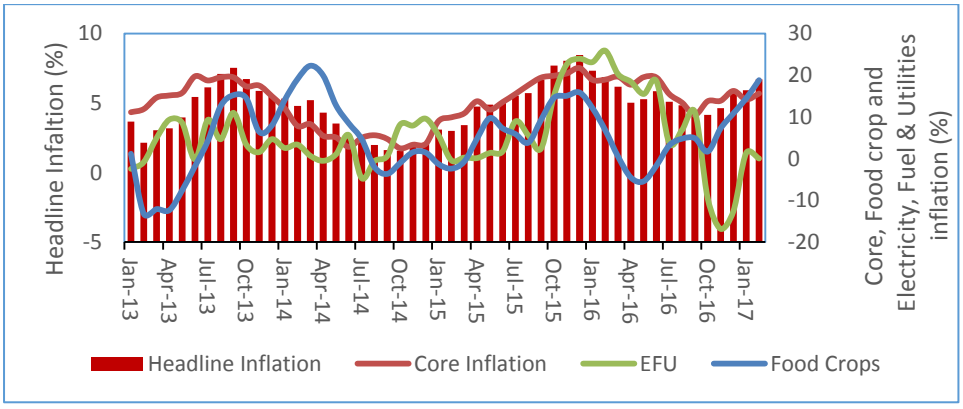


Source: Uganda Bureau of Statistics

1.2 Monetary policy: Attempts to stimulate the economy in the context of low inflation

Uganda's economy continues to be affected by a number of shocks that have had serious implications for price movements. Even so, the core inflation rate has remained within the target range of about 5 percent. According to the Uganda Bureau of Statistics' Consumer Price Index (CPI), the annualized headline (overall) inflation rate stood at 7.2 percent in May 2017, which was higher than 5.3 percent recorded in the same month in the previous year. The pressure largely came from the impact of the prolonged drought on food crops. Food prices have steadily increased since October 2016, with the rate of increase reaching 23 percent by May 2017. While this has contributed to instability, its impact has been partially offset by a number of internal and external factors. For instance, largely due to the gradual pass through of the low international oil prices, the energy, fuel and utilities component of the CPI declined steadily through 2016, before commencing to increase again in the three months prior to March 2017. With the combined impact of these movements, during the first eleven months of FY 2016/17, the average annualized inflation rate stood at 5.6 percent, with the core inflation rate (which eliminates volatile categories such as food crops and energy and utilities) at a slightly lower level, at 5.2 percent. Thus, the pass-through effect from the unfavorable climatic conditions for agriculture to the overall inflation rate has been limited.

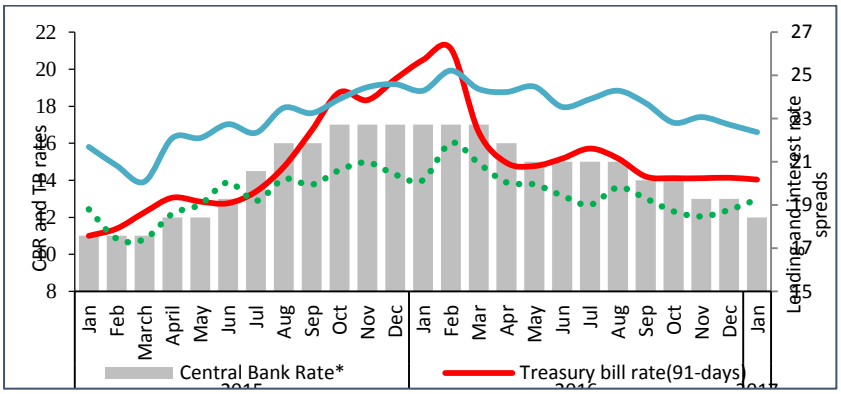
Figure 4: Despite food price increases, inflation remains within target levels



Source: Uganda Bureau of Statistics

Expectations that inflation will remain within the targeted range have facilitated the Bank of Uganda's (BoU) decision to ease its monetary policies and to lower its policy rates over the past year or more. Continuing a trend that commenced in April 2016, the BoU lowered the Central Bank Rate (CBR) significantly at several points throughout FY 2016/17. The CBR stood at 10.0 percent in June 2017, compared to the figure of 17 percent recorded a year earlier. So far, the lower policy rates have reduced returns on financial assets, including both Treasury Bills and deposits, thus encouraging savers to seek alternative investments. Another intended goal of the lower policy rates was to boost private sector activity by reducing the cost of credit to the sector. However, in terms of this goal, the reductions in the policy rates have had only a limited impact. Firstly, commercial banks have reduced their lending rates by only a very limited degree, with these rates declining from 23.5 percent in June 2016 to 23.1 percent in February 2017, before they were reduced more strongly to 20.5 percent in April 2017 (see Figure 3).[8] Secondly, the limited financial depth means that these policy actions have had only a limited impact on economic activity, with the proportion of the private sector having access to commercial loans remaining low.

Figure 5: Lower policy rates not yet fully reflected in lending rates



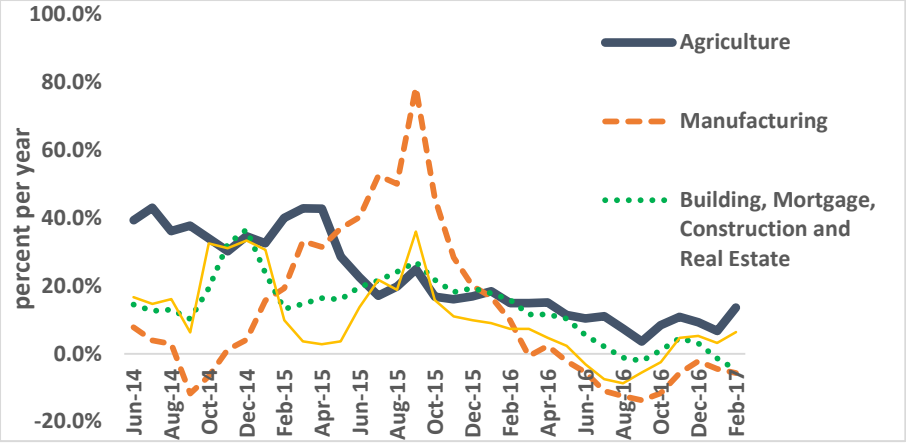
Source: Uganda Bureau of Statistics

The stimulus policies have resulted in a modest acceleration in the rate of expansion of credit and money supply after it had collapsed during the first half of FY 2016/17. According to data from BOU,[9] while the rate of growth of credit to the private sector had registered a negative annual growth rate of -1.1 percent by the end of September 2016, it had since gradually recovered, increasing to an average rate of growth of 5.2 percent during the subsequent quarter ending December 2016, and to 6.2 percent during the quarter ended March 2017. In a heightened risk environment characterized by the deterioration in the quality of loans and the increased recognition of foreign exchange risks, the commercial banks have been slow to reduce their lending rates. The greatest proportion of the loans they provide to the private sector was going to the transport, communications, business services; and personal and household sectors. The value of credit provided to the building, mortgage, construction, real estate, and manufacturing sectors have continued to decline, with the total value of credit received by the sectors being lower than in the previous year

[8] The correlation between BOU's policy rates and lending rates is 60 percent for Treasury Bills, 80 percent for the Bank and Rediscount Rates, and 90 percent for the CBR.

[9] BoU, Depository Corporations Survey (previously known as Monetary Survey), April 2017.

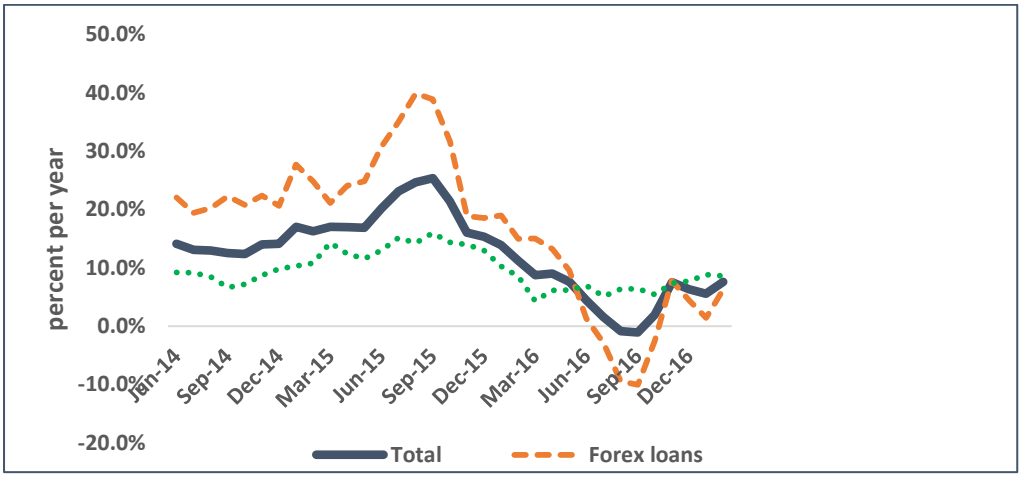
Figure 6 : Credit to the private sector: Acceleration since September 2016



Source: Uganda Bureau of Statistics

In tandem with expectations, commercial banks' increased recognition of foreign exchange risk has deterred agents from increasing foreign currency borrowing. Even though the denominated in foreign currency continue to contribute significantly to the growth in total credit when converted into shilling, the stock of these loans has been decreasing throughout most of FY 2016/17. During the first ten months, the total value of these loans decreased by 3.7 percent, contrasting with the modest increase of 1.4 percent recorded during the corresponding period in FY 2015/16. This is a very significant reversal, and collaborates the fact that commercial banks have tightened lending conditions due to the high level of volatility. The stock of loans denominated in local currency has increased at much faster rate, going up from 5.8 percent to 8.0 percent over the same period. The dollar-denominated credit accounted for 44 percent of the total value of credit extended by commercial banks by April 2017, which is only marginally lower than 44.6 percent recorded in April 2016. As has been discussed in previous editions of this report,[10] the loans denominated in foreign currency also create a significant exchange rate risk for borrowers, whose earnings are shilling-denominated, particularly in the case of entities operating in non-tradable sectors. In the case of a depreciation in the value of the local currency, it would become increasingly expensive for those sectors to service debt denominated in foreign currency.

Figure 7 : Increase in loans denominated in foreign currency since September 2016, mainly as a result of revaluation of these loans into local currency



[10] Most recently, see World Bank 2016 Uganda Economic Update, 8th Edition. Step by step, Let's solve the Finance Puzzle. Washington D.C. February 2017.

Source: Bank of Uganda

There has been a disturbing increase in the level of non-performing assets, with this being the main reason for slower credit and declining profitability of the banking system, the overall high level of capitalization notwithstanding. In FY 2015/16, the proportion of non-performing assets (NPAs) increased to an average of 4.4 percent, almost double the average level recorded in the previous year. By December 2016, this figure had increased to10.5 percent, before declining to 6.3 percent in March 2017. Both domestic and international factors have contributed to the increased credit risk, with the most significant factors relating to the restrictions on the private sector's cash flow resulting from the Government's delays in paying for goods and services supplied by this sector, the high cost of credit, and the exchange rate volatility, all of which have made it difficult for an increasing proportion of businesses to honor their commitments. This has resulted in an escalation of provisioning costs and the imposition of tighter lending conditions by banks. However, with most banks maintaining capital adequacy ratios well in excess of the required statutory minimums, the increase in NPAs has not resulted in the failure of most operators in the banking system. Indeed, only one bank, Crane Bank, has been subject to interventions and closure, with this bank being severely undercapitalized due to poor governance.

Adoption of strengthened standards for capital adequacy has helped stave off concerns regarding undercapitalization, albeit with some increase in costs for the sector. Recently, banks have increased their capital buffers ahead of the requirement for increased Basel III capital adequacy expected to become effective this year. The BoU has implemented a number of other measures to ensure the soundness of the financial sector, including the introduction of a capital conservation buffer (CCB) of up to 2.5 percent of risk-weighted assets (RWA) above the minimum capital requirements. Furthermore, all Domestic Systemically Important Banks will be required to maintain additional capital reserves to a value of between 1-3.5 percent of RWA in addition to the minimum capital requirements and to the CCB. Since the cost of additional capital is likely increasing on the margin, the increased capital buffers can be expected to have some impact on lending rates.

1.3 A weakening external position deflated activity in sectors with external links

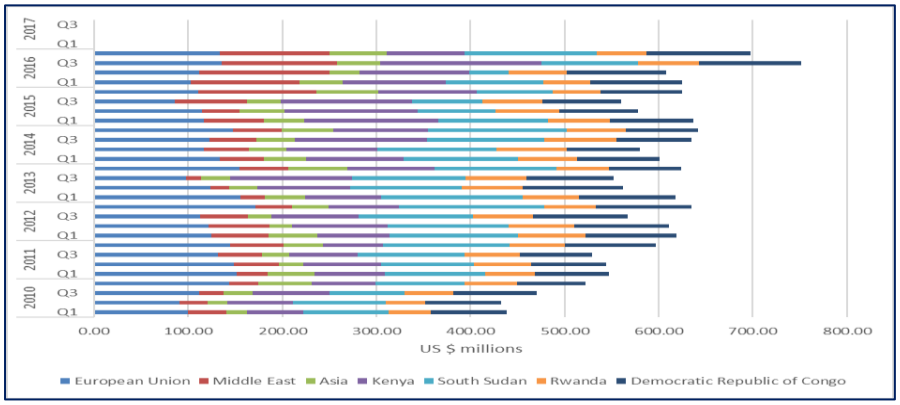
Over a siginificant part of FY 2016/17, Uganda's external position remained weak, with the impressive performance in terms of reducing the current account deficit being more than offset by the deterioration of long-term capital and finance. According to data published by Bank of Uganda[11], the current deficit stood at 5.1 percent of GDP by the end of December 2016, significantly lower than the figure of 7.4 percent recorded in the previous year, largely due to an improvement in Uganda's net export position. However, with the decline in the strength of capital and financial flows, a deficit in the overall balance of payments to a value of US$ 318.6 million was recorded by the end of December 2016, almost fully offsetting the surplus of US$ 390 million recorded in the previous year.

During the six months prior to the end of December 2016, the first half of FY 2016/17, an improvement in Uganda's net export position resulted from a reduction in its imports bill and from a modest increase in its exports. The contraction in the demand for imports may have been due to a number of factors, including the strong depreciation in the value of the Ugandan shilling over the last two years, the delayed implementation of a number of major infrastructure projects, and the decline in the value of the imports resulting from the sustained fall in global commodity prices, especially oil. The total value of merchandise imports in the first half of FY 2016/17 was 16 percent lower than that recorded in the corresponding period of FY 2015/16. Consequently, the total value of the imports of goods declined from a level equivalent to 19.6 percent of GDP to 16.7 percent over this period. At the same time, the total value of exports increased by 18 percent in the

[11] www.bou.or.ug; Statistics/External Sectors Statistics/Balance of Payments

six months to December 2016, primarily driven by a growth in the value of non-monetary gold. With global demand starting to increase, efforts to diversify markets beyond the region started to pay off, with the value of exports to Uganda's new markets in the Middle East and Asia growing strongly. In addition, domestic efforts to rejuvenate the production of major traditional exports, including coffee, began to have a positive impact. In the quarter ending in December 2016, Uganda exported 1,120,000 bags of coffee. This is a higher figure than has been recorded in any year since 1999. This increase is attributed to the improved quality of Uganda's beans, with farmers adopting improved drying methods; to increased coffee yields as a result of an extensive tree replacement program; and to the promotion of coffee cultivation outside traditional hubs.

Figure 8: Uganda penetrates new export markets



Source: Bank of Uganda

In the area of Uganda's net flows related to services and income, it has recorded a less impressive performance, due to a number of internal and external factors. During the first half of FY 2016/17, the total value of travel reciepts, which includes receipts from tourism, amounted to US$ 458 million. This figure is 24 percent lower than that recorded during the first half of FY 2015/16. This decline was the result of a number of factors, including the impact of regional terrorist incidents on consumer perceptions of the East African region; lower global incomes; the lingering impact of election-related uncertainties; the Kasese clashes in Western Uganda; and an outbreak of avian flu. Uganda continued to benefit from the low oil prices, with freight charges continuing on a downward trajectory that commenced in 2012, reaching a value of US$ 498 million in the first half of FY 2016/17, with this partially offsetting the negative impact of the other factors. Overall, the net value of foreign outflows related to services increased by 4 percent compared to the figure recorded in the corresponding period of FY 2015/16. There were also increased outflows related to primary investment income, mainly derived from foreign direct investment. As a result, the figure for the net outflow stood at US$ 421 million for the six-month period to December 2016, a dramatic increase over the figure of US$ 225 million recorded in the corresponding period of 2015. Only the value of personal transfers has increased, from US$ 497 million to US$ 563 million over this period, as remitters for these flows adjusted to reduced domestic uncertainties, following the completion of the election cycle in February 2016.

The volume of net flows of longer term capital started to increase during the first half of FY 2016/17, although it remains low. Thus, the position for the overall balance of payments did not improved significantly compared to the previous year. During the first half of FY 2016/17, the total value of disbursements by project grants stood at US$ 372 million, still lower than the figure of US$ 592 million recorded in the corresponding period of FY 2015/16. However, the overall value of FDI is estimated to have increased from US$ 269 million to US$ 426 million over the same period, with existing investors

making the decision to re-invest their earning. The value of direct investment equity in enterprises remained low, at only US$ 101 million, significantly lower than the figure of US$ 155 million recorded in the corresponding period in FY 2015/16, with investors adopting a wait-and-see approach in the context of flows related to oil production. With the interest rates on government securities declining steadily, investors withdrew a total value of US$ 33 million that had been invested in government securities during the first half of FY 2016/17. This more than reversed the US$ 36 million that they invested in these securities in the same period in the previous year.

The overall deterioration in the balance of payments position has been accompanied by a loss of foreign exchange reserves, with this effect exacerbated by an adjustment in the value of the Ugandan shilling. The value of foreign exchange reserves decreased by US$ 166.5 million in the first half of FY 2016/17. At the end of this period, the level of reserves was less than the buffer of 4.8 months of import cover that had been maintained until the end of the first half of FY 2015/16. Adjustments to the weakening external sector have involved a reduction in forex reserves, with the value of these reserves declining from 4.8 months of import cover to 4.3 months in the period from December 2015 to December 2016. The value of the shilling has remained stable in both real and nominal terms for most of FY 2016/17, despite some volatility at the beginning of the year. By the end of December 2016, the value of the Ugandan shilling relative to the US dollar was 7.0 percent lower than it was at the same point in 2015, but its real effective value was only 3.0 percent lower.

During the second half of FY 2016/17, a number of areas in Uganda's external position improved, with this allowing Bank of Uganda to rebuild foreign exchange reserves. With stronger inflows into services and income accounts, the deficit on the current account is expected to decline further to a value equivalent to 4.8 percent of GDP by the end of June 2017. Furthermore, on account of accelerated disbursements of long term loans, particularly the non-concessional loans financing large infrastructure projects, the overall balance of payments is projected to have registered a surplus, amounting to US $ 232 million, with this surplus expected to have allowed the Bank of Uganda to increase foreign exchange reserves to a value sufficient to cover five months of the import of goods and services by end of June 2017.

1.4 Planned fiscal expansion foiled by perpetual under-execution of projects

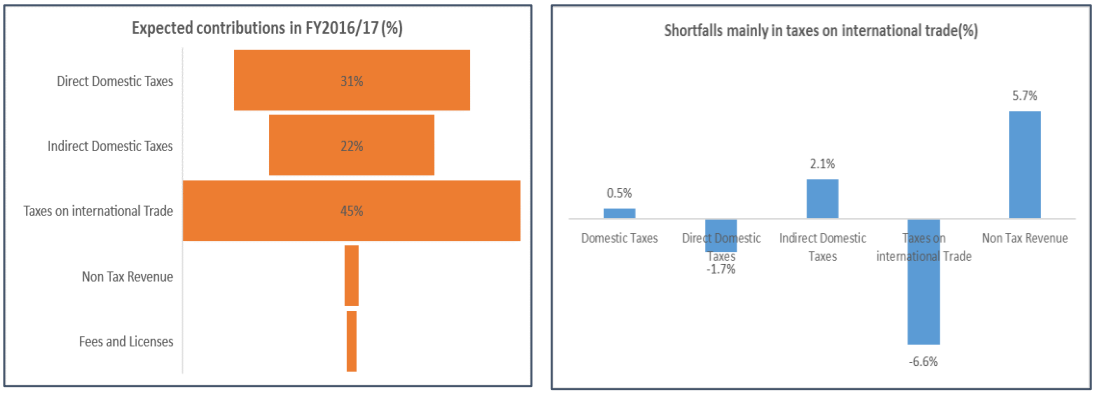
The Government's huge medium-term investment program continues to dominate Uganda's fiscal policy management. The authorities remain committed to fiscal policies intended to boost growth by addressing Uganda's infrastructure deficit. As has been the case over the past four years, the Parliament approved an expansionary budget for FY 2016/17, with a projected increase in total expenditure from 22.1 percent of GDP in FY 2015/16 to 22.4 percent in FY 2016/17. The value of domestic revenues was projected to increase from 13.8 percent of GDP to 14.4 percent, partly compensating for the decline in external grants, which were projected to drop from 1.4 percent of GDP to 1.1 percent. Therefore, according to the approved budget, the overall fiscal deficit had been envisaged to increase from 5.3 percent of GDP in FY 2015/16 to 6.4 percent, with more than 80 percent of the fiscal deficit funded through external loans, and with the bulk of these loans derived from non-concessional commercial sources.

A combination of shortfalls in tax collections as well as lower disbursements of external grants reduced the amount of resources available to the Government to spend by over a full percentage point of GDP, compared to the budget, which had stood at 16.2 percent of GDP. In the first nine months of FY 2016/17, the value of collected tax revenues amounted to Shs 9.24 trillion, representing a shortfall of about 2.5 percent relative to the targeted level. The shortfall was largely due to the lower than expected level of international trade taxes, with revenues in this category being the single most significant contributor to tax revenues (see Figure 9). Within international trade taxes, the most significant contributors to revenue are the petroleum duty and VAT on imports, with these accounting for approximately 40 percent and 30 percent of revenues respectively. While a surplus was recorded in the collection of petroleum duty, this was more than offset by shortfalls in other categories, especially in the case of VAT on imports, the value of which missed the target by 9.7 percent. The gap between the realized value of domestic taxes relative to the targeted level during this period was much smaller, at

1.7 percent in the case of direct domestic taxes and 1.1 percent in the case of indirect taxes. Overall, the total value of the gap between the revenues collected and the targets stood at Shs 282 billion. With the shortfall expected to persist to the end of the year, it is projected that the total value of tax revenues collected will amount to 13.3 percent of GDP in FY 2016/17. This is a higher ratio than that recorded in FY 2015/16 (12.8 percent), but it is lower than the budget target of 13.5 percent. The external grants are also expected to reach 1.1 percent of GDP by the end of the year, compared to the target of 1.8 percent in the budget. This implies that the total overall value of resources available to the Government, can be expected to reach an amount equivalent to 15.1 percent of GDP, compared to the original budget target of 16.2 percent.

Fiscal policy continues to be undermined by over spending on the recurrent budget, with this achieved through recurrent supplementary budget spending. Partly on account of spending pressures related to the food crisis in some parts of the country; increase of salaries for non-teaching staff; an outbreak of hostilities in the Kasese region in western Uganda; and increased levels of insecurity in some parts of the country that saw a deputy inspector of police gunned down, the Government increased recurrent expenditures beyond its original budget. Thus, a total of UGX 4,871 billion had been released in the six-month period up to the end of December 2016. This was equivalent to 50.7 percent of the approved budget, with this projected to increase to 103.5 percent if these expenditures rise to the projected UGX 9937 billion by the end of the financial year. Notwithstanding the fact that supplementary spending could adversely affect the credibility and effectiveness of the budget as a planning tool, part of this overspending was made possible through a supplementary budget, which by end of May 2017 had amounted to UGX 762 billion. This amount of supplementary spending is already above the threshold of 3 percent of the approved budget[12], as was the case in FY 2015/16. A number of activities financed through these supplementary budgets could have been avoided if there had been proper planning, as in the case of wages, for which the supplementary budget amounted to UGX 97 billion.

Figure 9: Uganda's domestic revenue collection: International taxes contribute highly, but fail to meet expectations in FY 2016/17



Source: Uganda Revenue Authority

[12] By end May 2017, the total supplementary budget for the year exceeded the threshold of 4 percent of the approved operational budget of UGX 18.4 trillion but within the 3 percent threshold when considering the total expenditure envelop which stands at UGX 26.3 trillion and includes statutory expenditures such as domestic debt refinancing, external debt repayments, interest payments, and domestic arrears.

The largest obstacle for fiscal policy to attain its objectives has remained the significant under-execution of the development budget. Thus, overall expenditure is expected to remain below the target levels established in the approved budget by over three percentage points of GDP. The rate of execution of public investments was unimpressive, especially in the case of projects funded by external partners, with only 34 percent of the budget being absorbed during the first nine months of FY 2016/17. While the implementation of the development budget was strong at the beginning of this fiscal year, it failed to keep the momentum through the year. Some key investments, including the Karuma and Isimba hydroelectric power projects, had been carried over from the previous year and had been expected to be frontloaded into the first half of the year. However, a number of issues related to assurance of quality of work after the Karuma dam wall developed cracks and the change of government's supervision team, resulted into some delays. The physical progress at this dam is currently estimated at about 51 percent and it is likely that the contractor will seek permission for an extension of completion date from August 2018 to 2019. Meanwhile, the works and transport sector has recorded the lowest rate of execution of their budget – by end of March 2017, the Ministry of Works and Transport had absorbed 22 percent of its budgeted resources while Uganda National Roads Authority absorbed 9 percent. The execution has been affected by setbacks related to contract management, land acquisition and social safeguards.

On account of the above developments, the nominal value of the overall deficit is expected to be lower than projected levels by about Shs 3,530 billion. Even against a lower nominal GDP, the fiscal deficit is projected to reach about 3.5 percent of GDP. This would be three percentage points of GDP lower than the target level established in the approved budget. The deficit will be funded mainly (up to 71 percent) from external sources. The lower deficit also allowed the Government to borrow from the domestic market, amounts that are close to the limits it set itself within the budget. Through the first half of FY 2016/17, the Government had borrowed a total of UGX 827 billion from the domestic market, which is equivalent to 0.9 percent of GDP. However, Government reduced its rate of borrowing during the second half of the year, such that this kind of financing is expected not to reach beyond one percent of GDP, hence slightly exceeding the figure of 0.9 percent of GDP in the budget. A key challenge with this financing strategy was the lack of coordination with the monetary policy. With less pressure on the import bill required to support the Government's infrastructure development program, the reduction in the fiscal deficit has translated directly into the lower external current account deficit, as discussed in section 1.3.

Table 1: Fiscal Operations

In percent of GDP	FY2013/14	FY2014/15	FY2015/16	FY2016/17 App. Budget	FY2016/17 Proj.
Revenues and grants:	12.6	14.2	14.9	16.2	15.1
Domestic revenues	**11.6**	**13.0**	**13.5**	14.4	**14.0**
o/w Tax revenues	11.1	12.3	12.8	13.6	13.3
External Grants	1.0	1.2	1.4	1.8	1.1
Total expenditure	**16.6**	**18.5**	**19.8**	22.5	**18.6**
Recurrent	9.5	9.9	10.9	10.4	10.7
Development	7.1	6.7	6.9	9.8	7.1
Domestic Development	4.4	4.2	4.1	4.7	4.6
Externally Financed Projects	2.7	2.5	2.8	5.1	2.5
Net Lending & Investment	0.0	1.6	1.8	1.9	0.6
o/w Hydro-power Project	0.0	1.3	1.8	1.9	0.6

Other (e.g. Clearance of domestic arrears)	0.0	0.3	0.1	0.4	0.2
Float	-0.5	0.1	0.4	0.0	0.0
Overall balance	**--3.5**	**-4.4**	**--5.2**	**-6.2**	**-3.5**
External Financing	1.3	1.2	2.9	5.4	2.5
Domestic Financing	2.2	3.2	2.2	0.9	1.0
o/w Petroleum Fund withdrawals	0.2	2.1	-0.1	-0.1	-0.1
Memorandum items:					
Nominal GDP (Shs billions)	70,458	77,845	84,907	92,878	92,734

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

2. Economic outlook

Uganda's economy is forecast to grow at the rate of about 5.2 percent over FY 2017/18. This will be a significant acceleration from the growth rate of 3.9 percent estimated to have been realized during FY 2016/17 or the average rate of 4.5 percent recorded over the past five years. It is expected that the impact of internal and external shocks that have negatively impacted the economy in the recent past will start to dissipate. As a result, it is expected that private investments will increase. Together with the significantly increased pace of construction on public projects, this is expected to support an acceleration in economic activity. This effect is expected to spill over into the following year, FY 2018/19, during which the economic growth rate is forecast to reach 5.6 percent, and into the medium term, when growth could reach above 6.0 percent. Regional instability, poor weather conditions, global uncertainty, and fiscal management remain the major downside risks. In the context of huge spending pressures, risks related to imprudent fiscal management and the failure of the investment program to generate higher levels of growth if not properly implemented may lead to unsustainable levels of debt.

2.1 Modest recovery if the impact of shocks recedes

The World Bank forecasts that Uganda's annual rate of economic growth will accelerate to around 5.2 percent during FY 2017/18. As the adverse effects of shocks dissipate, economic activity is anticipated to have accelerated during the final quarter of FY 2016/17, with this pushing the annual rate of GDP growth up from the figure of 2.6 percent recorded midway through the year, to about 3 to 4 percent by the end of the year. The increase will have been driven by improved macro-stability; improved weather as rains started; the increased supply of credit to the private sector given that the commercial banking sector's high level of liquidity; increased private sector investment; and the ongoing implementation of infrastructure projects. These same effects should drive growth into FY 2017/18, to a rate reaching 5.2 percent. Over the medium term, if existing uncertainties related to fiscal management and other constraints on growth are addressed, Uganda's rate of economic growth should gradually increase to 5 percent or above, an increase over the average rate of 4.5 percent recorded over the past five years. This will also be supported by a recovery in FDI inflows to the extractives sector following the issuance of exploration agreements and the Government's renewed re-prioritization of the development of oil-related infrastructure that has been followed by the signing of the agreement between Uganda and Tanzania for the construction of the oil pipeline East African Crude Oil Pipeline Inter-Governmental Agreement (EACOPIGA) for exporting oil between Hoima and Tanga port. Therefore, it is expected that the increased rate of growth will continue to be driven by the construction and services sectors.

The projected growth is expected to reduce poverty by an estimated 0.9 percentage points per year in the period from 2016 to 2019, with the poverty rate expected to fall to 28.8 percent by 2019/20. If these forecasts are realized, Uganda's average per capita income is expected to increase to about US$ 720 by FY 2019/20. Economic growth is expected to have a disproportionately significant impact in the Central and Western regions, hence widening regional disparities. As of 2013, close to 43.7 percent of the population in the Northern region and 24.5 percent in the Eastern region were living in poverty, significantly higher than in the Western and Central regions, where the figures stood at 8.7 percent and 4.7 percent respectively.

The authorities must maintain a delicate balance between leveraging fiscal policy to stimulate economic activity while at the same time ensuring the shocks do not transmit into macro policy slippages. The fiscal budget for FY 2017/18 has been formulated with the intention of delivering macroeconomic stability to support inclusive and sustainable economic growth; and facilitating socio-economic transformation. For these twin objectives to be achieved, two measures are essential: (i) strong efforts to achieve value for money from the increased expenditure; and (ii) improved budget execution to limit deviations from the planned allocation of public resources. According to the Budget Framework Paper for

2017/18-2022/23, the Government plans to stimulate aggregate demand and supply through increased overall spending and an increased emphasis on capital expenditures, with these expenditures expected to be reduced after major infrastructure projects are completed. Therefore, following the completion of the Karuma and Isimba hydroelectric power projects, the fiscal deficit is expected to decline to below five percent of GDP over the medium term.

1. **According to the FY 2017/18 National Budget, the total value of expenditure is forecast to increase by 10 percent from UGX 26,360 billion, to UGX 29,008.5 billion.** As a share of GDP, this expenditure is estimated to slightly increase to 19.7 percent of GDP, up from the level of 18.6 percent estimated for FY 2016/17. With the perceived need to implement priority infrastructure projects to facilitate private sector development and to enhance the productive capacity of the economy, the infrastructure sectors (transport, energy and water) received the largest allocation, up to a value equivalent to 34.3 percent of the budget. Specifically, 21 percent of the budget has been allocated for the development of transportation infrastructure, compared to 19 percent in the FY 2016/17 budget. In particular, the construction of roads and bridges to ensure oil production by FY 2020/21 has been prioritized, creating a monopoly over the increase in budget resources during this period. The allocation to the energy sectors decreased slightly, to 10.5 percent of the budget, from 11.6 percent allocated in FY 2016/17, but its key aim remains to support the completion of Karuma and Isimba hydroelectric power project and to construct power lines to support the distribution of electricity, especially in the rural areas.

2.

3. **The need for improved infrastructure notwithstanding, the sustained reduction in allocations to the social sectors could have significant longer-term negative effects.** While allocations to the education sector increased by 1.2 percentage points, allocations to all the other social sectors have been reduced. In particular, allocations to the health; water and environment; and social development sectors were reduced by 0.3 percent, 13.6 percent and 13.3 percent respectively, relative to sectoral budget allocations in FY 2016/17. The provision of insufficient resources to these sectors has the potential to exacerbate the dire living conditions of the poor and/or to reduce productivity at the household level. In a more positive development, allocations to the agricultural sector have increased by 4.9 percent, with this increase expected to support productivity improvements and to enable a greater number of people to engage in this sector. This, and the possibility that improved infrastructure could raise farmers' productivity and link them to markets, could raise average incomes and at least partially offset the risks associated with the reduced spending on the social sectors.

With domestic revenues expected to grow only slightly to reach the value of 14.5 percent of GDP during FY 2017/18, the Government intends to borrow to finance the budget. The value of collected revenues has been lower than targeted levels for two consecutive years. If the Government is unable to resist a new wave of demands for tax exemptions, it may continue to be difficult for the Uganda Revenue Authority to meet its targets. The fiscal deficit will reach a value of 6.4 percent of GDP in FY 2017/18, with more than 80 percent of the fiscal deficit funded through external borrowing. The value of net external borrowing is projected to reach 5 percent of GDP, with about three-quarters of this coming from commercial sources (non-concessional loans). Domestic financing is projected to amount to 1.3 percent of GDP, consistent with the Government's debt management strategy to limit its degree of dependence on this expensive source of financing

The fiscal authorities face a significant challenge in their endeavors to finance proposed expenditures while maintaining debt at a reasonable level to ensure that the cost of debt servicing does not reduce its space to engage in critical expenditure. The budget allocated a total of Shs 9,641 billion to meet the cost of servicing debt falling due as well as unmet obligations within the year (arrears) or beyond (debt). Of this, the cost of domestic debt roll-over is expected to reach Shs 4,999 billion, which amounts to 17 percent of the total value of the national budget, while the cost of debt amortization and meeting domestic arrears constitute another 3.3 percent and 1 percent of the budget respectively. Up to 12 percent of the sectoral budget has been allocated to meet the cost of interest payments, with this allocation having increased sharply in FY 2017/18, on account of increased debt levels and a shortening of the maturity spectrum of

Uganda's debt. The impact of this is complicated. The reliance on external borrowing helps reduce the impact in terms of the crowding out of longer-term finance, but the Government is still engaging in significant borrowing at the short end of the domestic market. The increased allocation to meeting domestic arrears will be welcomed by the private sector, with a large number of private-sector operators facing liquidity constraints as a result of having supplied goods and services to the Government, but not being paid on time.

It is crucial to enhance the level of coordination between monetary and fiscal policy to address challenges related to financing the expansive fiscal policy. On the one hand, the authorities may be motivated to continue to ease the monetary policy in order to increase the availability of credit to the private sector. However, these measures will only be effective if they are well-coordinated with the financing needs of the public sector. With increased public expenditure, the Government's domestic borrowing has increased beyond the benchmarks established by the 2013 Public Debt Management Framework. At least to some degree, there has been a correlation between this increase and the low rate of growth of credit to the private sector. The total value of government domestic borrowing in the first quarter of FY 2016/17 stood at Shs 678.6 billion, already in excess of the limit established by the annual approved budget, with this limit being set at Shs 602 billion. The Government must manage future borrowing appropriately to ensure that it does not crowd out the private sector.

As fiscal authorities continue to reduce domestic debt issuance, they should resist the temptation to increase central bank financing. During FY 2016/17, the Government's decision to reduce issues of domestic debt was a welcome development. However, to close the gap, the Government opted for a higher level of reliance on advances from BoU and a delay in the repayment of earlier advances. As has been experienced in Uganda during the 1970s and 1980s, and in many other countries, central bank financing of the fiscal deficit can complicate liquidity management and undermine the credibility of monetary policy, especially under an inflation targeting regime that Uganda adopted since 2015.

In the medium-term future, the pattern of Uganda's economic growth can be expected to remain the same as in the past decade, with the predominant source of growth being increased economic activity in the construction and services sectors. The manufacturing sector is also expected to continue to expand, albeit from a very small base. Though still only contributing to a small proportion of GDP, the mining and quarrying sector could be a significant source of growth in future years if the sector's proven potential starts to attract increased attention from investors. Growth in the output of the agricultural sector is expected to remain subdued due to supply-side constraints, with this limited growth constraining attempts to achieve a more rapid reduction in poverty.

In the context of global economic uncertainty, growth in the value of foreign direct investment flows and tourism and private transfers will remain subdued. Combined with the increased imports of inputs for infrastructure projects, this will result in a further widening of the external current account deficit to a value in the range of 8-10 percent of GDP in FY 2017/18 and FY 2018/19. In the short term, the planned increase in public expenditure will most likely curtail a build-up of international reserves beyond the current levels of about 4.0 to 4.5 months of import cover.

Table 2: Uganda / Macro poverty outlook indicators ((annual percent change unless indicated otherwise)

	2014	2015	2016	2017 e	2018 f	2019 f
	2014	2015	2016	2017	2018	2019
Real GDP growth, at constant market prices	5.1	5.2	4.7	3.4	5.2	6.0
Private Consumption	2.0	7.7	1.8	2.5	5.0	6.2
Government Consumption	7.5	15.5	-5.0	-1.7	0.5	-2.0

Gross Fixed Capital Investment	2.5	-0.5	8.9	2.8	5.5	6.5
Exports, Goods and Services	0.2	-2.4	3.6	2.5	5.5	6.5
Imports, Goods and Services	-7.4	4.6	-3.8	-2.5	3.2	4.5
Real GDP growth, at constant factor prices	4.2	5.4	5.1	3.2	5.3	6.1
Agriculture	2.7	2.3	2.8	-1.2	2.5	3.2
Industry	6.3	7.8	4.7	4.0	5.5	6.2
Services	4.2	5.9	6.4	4.8	6.4	7.2
Inflation (Consumer Price Index)	4.3	5.2	5.5	5.5	5.0	5.0
Inflation (Consumer Price Index)	4.3	5.2	5.5	5.5	5.0	5.0
Inflation (Private Consumption Deflator)	7.0	6.4	7.1	6.0	5.3	5.2
Inflation (GDP Deflator)	3.5	5.1	3.3	5.5	5.0	5.0
Current Account Balance (% of GDP)	-7.9	-8.4	-6.6	-5.1	-4.5	-4.1
Financial and Capital Account (% of GDP)	6.1	3.2	3.4	2.8	2.3	2.1
Net Foreign Direct Investment (% of GDP)	4.1	3.3	2.2	2.1	2.2	2.2
Fiscal Balance (% of GDP)	-3.6	-4.4	-6.6	-4.3	-4.2	-4.3
Debt (% of GDP)	32.4	31.1	32.0	38.3	39.3	40.5
Primary Balance (% of GDP)	-2.0	-2.7	-4.7	-2.4	-2.0	-2.0
Poverty Rate a, b, c						
Poverty rate ($1.9/day PPP terms)[a,b,c]	33.7	32.7	31.8	31.1	30.0	28.8
Poverty rate ($3.1/day PPP terms)[a,b,c]	64.4	63.6	62.9	62.4	61.6	60.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Notes: e = estimate, f = forecast, Data reported in financial years July-June

(a) Calculations based on 2009-UNHS and 2012-UNHS.

(b) Projection using point-to-point elasticity (2009-2012)
with pass-through = 1 based on GDP per capita in constant LCU.

© Actual data: 2012. Nowcast: 2013 - 2016. Forecast are from 2017 to 2019

2.2 Risks: The **Immediate and Critical Arise from Fiscal management**

The economic outlook faces a number of immediate and critical risks. In particular, these risks relate to fiscal management in the context of the low revenue base and the high spending pressures. If not managed carefully, these risks could have implications on the Government's ability to finance its investment program and to manage its level of debt. In particular, in its implementation of fiscal policy, the Government must move to contain leakages from the domestic revenue and to manage a range spending pressures. While the Government is considering granting tax relief to a number of domestic companies to stimulate the growth of key sectors of the economy and to address employment and export bottlenecks, this will adversely impact its revenue collection performance. Another risk relates to the sequencing, financing and management of the public infrastructure development program. In the immediate term, as the Government

accelerates investments in the development of infrastructure for oil production, considerable risks related to the financing of investments remain.

If the Government's huge investment program does not result in the high rates of growth necessary to justify the expenditure or if projects are delayed significantly (as has been the case in the past with several energy projects), this could result in rapid increases to the debt-to-GDP ratio, most likely to a level in excess of the threshold of 56 percent of GDP, the present value-debt threshold for medium CPIA performers. According to an update to the Joint World Bank/IMF Debt sustainability analysis conducted in November 2016, Uganda continues to be at a low risk of debt distress, with the present value of public debt-to-GDP ratio projected to peak at about 36 percent in FY2021.[13]

Uganda's level of debt sustainability remains vulnerable to a number of variables, with associated risks leading to the downgrading of Uganda's long-term debt risk rating by a number of credit rating firms. These variables include: (i) the rate of depreciation of the value of the shilling, which affects the cost of servicing external debt; (ii) the rate of GDP growth, fiscal revenue, and exports, which affects the ability to service debt; and (iii) the strength of the institutions, which affects the thresholds for assessing debt sustainability. In particular, in the context of Uganda's rapid fiscal expansion, the continued failure to collect adequate levels of revenue has contributed to an increase in the risk of debt distress. In November 2016, Moody's downgraded the long-term issuer rating of the Government of Uganda from B1 to B2, but changed the outlook from negative to stable. The downgrading of Uganda's credit rating was based on Moody's perceptions of the sustained erosion of Uganda's fiscal strength and the rapid increase in its debt burden to 33 percent of GDP, with this burden projected to increase to up to 45 percent of GDP by 2020. Indicators of reduced debt affordability include a rise in the debt-to-revenue ratio, which is expected to exceed 250 percent by 2018, at which point interest payments are expected to consume 16 percent of revenues. This far exceeds the median level for B-rated countries, with the median standing at eight percent. Nonetheless, Moody's upgrading of the outlook to stable reflects the fact that Uganda's credit fundamentals will stay at roughly the same level as peers in the B2 category.

In addition, the proportion of domestic debt has increased from 8 percent of GDP in FY 2009/10 to 14 percent in FY 2015/16. While this proportion fell to 12 percent during FY 2016/17, it is expected to increase to 16 percent in FY 2017/18. While this increase may assist in the development of the capital market, it risks crowding out private sector investment, with the consequent higher interest rates increasing the private sector's cost of borrowing. In recent times, with the increasing development of longer term markets, the market has expressed a preference for Treasury bonds rather than Treasury bills. Increased government borrowing has increased the cost of domestic borrowing, with the share of interest payments on the domestic debt in proportion to total interest payments increasing from 81 percent in FY 2014/15 to 87 percent in FY 2015/16.

Uganda remains vulnerable to a number of exogenous shocks, including shocks related to fluctuations in the prices of its main exports and imports, regional insecurity, and volatile climatic conditions. Volatile commodity prices and financial distress in industrialized countries could have adverse effects on Uganda's external position, exacerbating domestic inflation and complicating the financing of its budget. Private investments could stagnate or decline if Uganda's fragile regional markets are eroded by political tensions and civil unrest in neighboring countries, particularly those related to the civil unrest in South Sudan, or to potential disruptions to trade in the context of the upcoming elections in Kenya, as was the case around the 2007 elections. Uganda also remains vulnerable to risks associated with volatile climatic conditions and food prices, particularly given the limited implementation of mitigation measures involving irrigation systems. With

13 Under the Country Policy and Institutional Assessment (CPIA), Uganda is classified as a medium policy performer, with a CPIA score of 3.73 (3-year average, 2013–15). All data refer to fiscal years running from July to June (e.g., FY2016 covers July 2015 to June 2016, abbreviated as 2016 in the figures and tables). External debt is defined as foreign-currency denominated debt for purposes of the DSA.

agriculture remaining the primary source of livelihood for more than 69 percent of the population, supply disruptions resulting from change in weather patterns could have significant negative effects on consumption and livelihoods and could complicate the management of inflation.

Lastly, with poor performance in the area of domestic revenue mobilization and considerable uncertainty regarding the commencement of oil production and the subsequent flow of revenues, there remains considerable risks to the financing of investments in the country. On one hand, the Government's rapidly expanding infrastructure development program must be appropriately managed and sequenced to avoid unnecessary hike in financing risks. Even then, the financing of public investments is highly dependent on volatile sources of external financing, with the utilization of domestic resources currently limited by the shallow capital market. Sustained increases in global interest rates could constrain the ability of the Ugandan government to raise this financing, hence narrowing the scope for this financing. On the other hand, the total value of the required investments required to support Uganda's transformation is significant and it is unlikely that that existing fiscal space would be sufficient finance this need. This calls for the Government to tap into non-traditional approaches to alleviate the infrastructure financing gap. Among other means, the Government ought to unleash the power in public-private partnerships.

2.3. Addressing Uganda's infrastructure finance challenge: The need to look beyond the ordinary

The Government of Uganda's Vision 2040 statement expresses its aspiration of transforming Uganda from a predominantly agricultural and low-income country to a competitive upper middle-income country. In order to manifest these aspirations, the Government has expressed its intention of implementing a number of ambitious infrastructure projects, particularly in the energy and transport sectors, but also to support the social sectors through improvements to water, education, and health infrastructure. Infrastructure is both capital-intensive and a long-term investment. While it requires access to significant amounts of funding, it can also be expected to yield significant financial benefits over the long-term.

The Government has already directed significant efforts to improve the quality of Uganda's infrastructure. However, Uganda still lacks the full range of capital goods required to provide the services and inputs to support the achievement of sustainable development. Compared to other developing countries, Uganda ranks relatively lowly in terms of many aspects of infrastructure development. According to the World Economic Forum's Global Competitiveness Report of 2016/17, in terms of the basic requirements for competitiveness, Uganda ranks in 126th place out of 140 countries, with a score of 2.43 in terms of the report's infrastructure index. This places Uganda behind a number of other countries in the sub-Saharan African region, including Kenya, which ranks in the 98th position, with a score of 3.35; Tanzania, at 118th place, with a score of 2.67; Ghana, at 111th place, with a score of 2.88; and Ethiopia, at 115th place, with a score of 2.78.

The Government has also allocated substantial amounts of funding for infrastructure. However, Uganda continues to be affected by a large deficit in financing for infrastructure. By 2012, Uganda was already spending approximately US$ 1 billion each year, an amount equivalent to six percent of GDP, on infrastructure.[14] Over the past four years, the value of Uganda's expenditure on infrastructure has increased rapidly, with the Government endeavoring to remove binding constraints on growth and to prepare for the production of oil. In FY 2017/18, total expenditure on infrastructure is anticipated to reach above seven percent of GDP. In the three-year period up to FY 2019/20, when the current National Development Plan expires, this proportion is expected to gradually decline as the Government completes a number of key strategic projects. However, over these years together, the equivalent value of spending on infrastructure is expected to reach US$ 13 billion. While this expenditure is significant, it is still below the level required to close the infrastructure gap.

[14] World Bank, 2012, Uganda's Infrastructure.

It has recently been estimated that the annual infrastructure funding gap amounts to a value of around US$ 0.4 billion a year.

The development of infrastructure has also been affected by the inefficiencies in the management of public investment. Over the recent past, the Government has implemented an expansive fiscal policy intended to address the infrastructure gap. However, these policies have only been partially successful. On average, 36 percent of the planned expenditure over this period did not materialize, with the bulk of the recorded under expenditure being in the priority sectors of energy and transport[15]. Challenges to the execution of budgets are exacerbated by overall inefficiencies in the investment process, significantly eroding the value of these investments, and hence reducing the overall value for money. It has been estimated that up to US$300 million is lost annually due to inefficiencies in spending[16]. Increasingly, economic growth has been driven by increased consumption. There are also indications that there has been a decline in the level of efficiency of utilization of public capital. These investment inefficiencies must be addressed to facilitate the achievement of an increase in the rate of accumulation of capital and thereby to facilitate significant positive socio-economic transformation. This will only be achieved if public expenditure results in higher levels of actual capital accumulation for each unit of investment.[17]

[15] World Bank 2016, Seventh Uganda Economic Update; Uganda- From Smart Budgets to Smart Returns: Unleashing the power of public investment management, May 2016

[16] World bank, 2012, Uganda's Infrastructure.

[17] World Bank 2016, Seventh Uganda Economic Update; Uganda- From Smart Budgets to Smart Returns: Unleashing the power of public investment management, May 2016

Part 2: Public-Private Partnerships: A potential means to mobilize Uganda's infrastructure finance

- Addressing Uganda's infrastructure deficit would require a multi-pronged effort to raise capital to close the funding gap as well as to address inefficiencies to maximize value for money in these investments.

- The estimated level of investment required for Uganda to close the infrastructure gaps amounts to almost US$ 1.4 billion per year in the medium-term. This is about six percent of Uganda's GDP per year. It is also estimated that a total of about US$300 million is lost annually due to inefficiencies in infrastructure spending.

- If structured appropriately, public-private partnerships (PPPs) can help mobilize resources to help fill these infrastructure finance gaps, with a possibility of such arrangements bringing in private financing, development and management; as well as facilitating the achievement of higher levels of efficiency.

- Use of PPPs must be must be combined with a recognition of their limitations and the fiscal risks that may result in outcomes differing greatly from the forecasts or expectations. Therefore, it is important to have clear frameworks to assess, manage and backstop these risks.

- PPPs can be successful only if the Government is committed to building the right set of frameworks to provide the appropriate environment for private investments and adopting robust project identification, screening, procurement and contract management processes.

- PPPs can only be successful to the degree to which they can attract long term financing, especially given the availability of long-term financing is extremely limited in Uganda. The pension sector, representing the largest pool of long-term domestic capital in Uganda must be reformed so as to play the key role of providing long-term finance for PPPs in Uganda.

- Domestic currency financing is limited and financing for PPPs will require Uganda to work towards appropriate de-risking of projects in order to attract equity and debt financiers.

3. Public Private Partnerships: Big 'pros', but 'cons' as wells

As international experience demonstrates, Uganda has the opportunity to leverage private sector finance to address its infrastructure gap, particularly through public private partnerships (PPP). PPP involve partnerships between the Government and the private sector to finance and manage infrastructure assets and to facilitate the provision of services over the long-term, with some transfer of risk. PPPs work on the premise that the private sector's involvement can result in greater value for money through the private sector's superior ability to improve efficiency by delivering projects on time and at cost, with enhancements in quality and coverage.

Around the world, an increasing number of governments are delivering public goods and services by entering into partnerships with the private sector to close financing gaps and to improve delivery capabilities. These arrangements can support the much-needed crowding in of private sector investment, thereby assisting governments to achieve their development objectives. Middle income countries such as Malaysia, Colombia, China, Brazil, Mexico, and Turkey are increasingly using PPPs to finance their infrastructure projects. These countries have large economies and they are therefore able to develop projects of a scale and quality attractive to private investors. They also have well-developed financial systems to provide the funding and the technical abilities to support the construction of these projects. In these countries, projects involving partnerships with the private sector have an average value ranging from 0.4 percent to 0.7 percent of GDP. This is almost twice the overall average value of projects across all countries, with this average standing at 0.2 percent to 0.4 percent of GDP. _

In Africa, PPP projects have a much lower average value, with projects of this sort being concentrated in only a few countries. Over the past two and a half decades, 335 PPP projects have been implemented in Africa, with the total value of these projects amounting to US$ 59 billion. Projects in South Africa have accounted for 85 of the total, the highest number of any single country on the continent. Nigeria has accounted for 35 projects, while Kenya and Uganda account for 22 projects each. By 2013, the greatest proportion of these projects was in the telecommunications sector, with projects in this sector accounting for 75 percent of the total. However, the proportion of projects in the telecommunication sector has been declining, with increases in the number of investments in energy and transport.

Not only do PPPs enable governments to access private sector finance to make much-needed investments, they also have a number of other advantages. Generally, a PPP can be viewed as: "A long term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance." PPPs can be arranged in many different formats, depending on the type of asset that is being constructed, the magnitude of the responsibility accorded to the private partner, and the mode of repayment of the funds utilized to put the asset into use. Irrespective of the format, these arrangements generally carry a number of advantages, including the following:

(i) PPPs enable the mobilization of additional sources of funding for large scale investments, particularly investments in infrastructure, in an efficient manner so that institutions that have surplus resources provide upfront capital that can be repaid later.

(ii) PPPs can allow public expenditures related to the capital cost of infrastructure assets to be spread over time. In an effort to prudently manage their budget constraints, governments are not in a position to finance all desired projects, even in the case of commercially viable infrastructure projects. Alternative financing from PPs can overcome this constraint.

(iii) PPPs can generate higher levels of revenue, and it is often easier for this to be achieved if these services are managed and operated by the private sector rather than by the public sector

(iv) PPPs can help increase the quality of public projects. Assumptions regarding the viability of the projects are subject to assessment by the market of potential investors, resulting in improved selection.

(v) PPPs can facilitate the timely implementation of projects and minimize cost overruns. Because private sector operators typically do not receive payment under a PPP contract until the facility has been completed and is available for use, they are highly motivated to ensure that the project is completed within the defined time frame. Thus, the PPP structure encourages the timely completion of projects. Transferring construction risk means that the Government should not bear the burden of any over-runs in construction costs, which in turn results in improved efficiency.

(vi) PPPs can play a role in ensuring that projects are appropriately maintained. Transferring performance risk to the private sector means that returns to investment are only realized if the asset performs according to contractual obligations, which in turn provides incentives for adequate maintenance.

(vii) PPPs can play a role in facilitating innovation. PPP contracts specify obligations to produce specific outputs, rather than prescribing inputs. This creates opportunities and Incentives for innovative approaches. The use of competitive procurement processes incentivizes bidders to develop innovative solutions to meet contractual specifications.

Box 4: Defining features of PPPs

A PPP is defined as a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and responsibility is linked to performance. There can be several PPP contract types, with various combinations of the following broad parameters:

(i) Type of asset involved: PPPs can involve new assets (green-field projects) as has been the case for projects like Bujagali Hydroelectric Power Project. They can also be used to transfer responsibility for upgrading and managing existing assets to a private entity (brown field), with this mainly encountered during the privatization processes, as was the case of Nile Hotel and Conference Centre).

(ii) Responsibilities accorded to the private partner: A central characteristic of a PPP is that it bundles together multiple project phases. Nonetheless, the functions for which the private sector is responsible vary and can depend on the type of assets and service. Typical functions can include a combination of designing, constructing or rehabilitating, financing, maintaining and operating.

(iii) Payment mechanism: The private party can be paid by collecting user fees from service users, by the government, or by a combination of the two, with the common defining characteristic being that payment is contingent upon performance. The payment mechanism usually depends upon a combination of factors including functional and risk allocation features of the contract.

(iv) *Financing mechanism*: PPP financing may come from the public, private or development finance institutions, or a combination of various sources.

Source: World Bank, Reference Guide on Public-Private Partnerships Version 3.0, 2017

However, PPPs have their limitations that might result in lower value for money for the government. If PPPs are not selected and implemented appropriately, they can also raise the cost of public investment if they turn out to be more expensive than would be the case if they were implemented as publicly procured projects. Many projects may not be suitable for implementation under PPP arrangements, and others might not enable adequate transfer of risk resulting in fiscal commitments and contingent liabilities for the government. Even in projects which generate additional financing through the levy of user charges, government may bear certain risks such as the demand, forex, interest rate and inflation risks through provision of guarantees. PPP agreements also contain termination clauses which might result in significant contingent liabilities for the government.

PPPs may not be able successful in enabling the provision of infrastructure, unless underlying inefficiencies are exhaustively addressed. Although PPPs can bring in financing, infrastructure deficits are ultimately caused by deficiencies in the governance and management of the sectors, through underpricing, inefficient operations and poor implementation. Introducing PPPs into a situation where there are major financial and regulatory will not fix the problem without improving governance and management of the sector.

4.0 Can PPPs deliver the expected outcomes?

Both the benefits and limitations of PPPs discussed above suggests that there are specific conditions required to exist for PPPs to contribute to the objective of raising additional infrastructure deliver PPPs and raising efficiency of these investments. It is clear that PPPs can only expand the fiscal envelope for the development of infrastructure if they result in improved efficiencies and/or improved collection of revenues compared to projects implemented through public provision and financing. Thus, the appropriate systems and frameworks must be in place to carefully analyze project proposals to ensure they are feasible, to ensure that they can attract private investors, and to ensure that they will provide value for money. These conditions are discussed in the sections that follow, with the aim to highlight the progress that Uganda has made in these respects and the gaps that need to be closed.

4.1 First prerequisite: A strong Framework for PPPs

Sound, transparent legal and regulatory frameworks are an important prerequisite for the implementation of a sustainable PPP program. These frameworks should clearly define the roles and responsibility of all the participants in the program and the rules according to which they interact. As such, these frameworks are critically important to attract private investment. In a high-cost and high-risk environment, the appropriate regulatory frameworks are required to ensure peace and stability, the rule of law, transparency and accountability, property rights and the enforcement of contracts, and to instill confidence in investors. For example, it has been found that a single standard deviation deterioration in the quality of regulations is associated with a reduction in the value of investments by four percent, while for each additional project requiring adjudication by the courts due to differences between the public and private parties, the level of investments may decline by four percent.[18]

Uganda has formulated a PPP Policy Framework, with this framework deriving its legal force from the implementation of the PPP Act of 2015.[19] **T**he PPP Act seeks to regulate the identification, preparation, procurement, implementation, maintenance, operation, management, monitoring and evaluation of PPP throughout the project cycle. It also creates an institutional framework with appropriate roles and responsibilities for the conduct of different functions and processes. The PPP Act follows standard international practice, with the decision-making and facilitating functions embedded within the Ministry of Finance, Planning and Economic Development (MFPED), while the line ministries fulfil specific core project implementation functions.

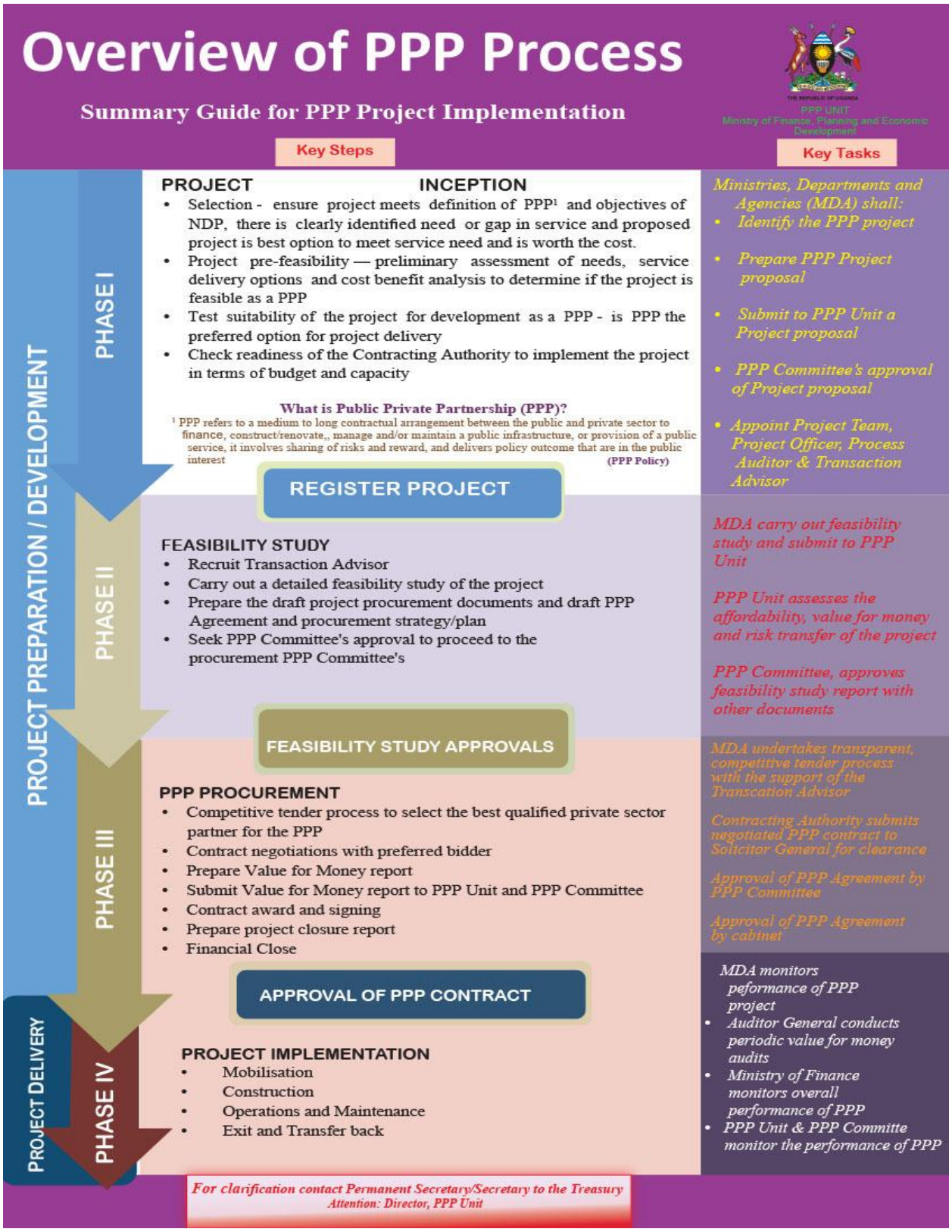
Critically, the PPP Act 2015 centralizes the responsibility for all potential PPP projects within the PPP Unit. This is a major improvement over earlier practices, in which each ministry made its own arrangements, often involving non-traditional procurement approaches by private parties. The Act ensures that all agencies adopt the same methodologies and processes and empowers the PPP Unit to assess and manage the Government's exposure to contingent liabilities and fiscal

[18] World Bank, 2014. Moszoro M, G. Araya, F. Ruiz-Nuñez and J. Schwartz. Discussion Paper 2014.5 Institutional and Political Determinants of Private Participation in Infrastructure.

[19] Government of Uganda, Public-Private Partnership Framework Policy, Ministry of Finance, Planning and Economic Development, September 2010.

risks related to the procurement and implementation of PPPs. The PPP Unit is responsible for identifying, appraising, developing, procuring and monitoring PPP projects. The PPP process is summarized in Figure 10 below.

Figure 10: PPP Project Cycle in Uganda



Source: PPP Unit, Ministry of Finance, Planning and Economic Development

While the PPP Act establishes a sound framework for the management of PPPs in Uganda, actual implementation must be improved if the Act is to fulfil its intended purpose. As is required by the Act, the PPP Committee has been established and is functional. However, members of this committee require training in key aspects of the management of PPPs to enable them to make well-informed decisions related to the approval of projects at each stage of the process. In addition, a number of key steps have yet to be taken, including approving and issuing PPP regulations and guidelines, staffing and resourcing the PPP unit, producing standards and manuals, creating a framework for assessing and managing fiscal commitments and contingent liabilities, formulating guidelines for disclosure of project and contract information, conducting capacity building and training of PPP unit and contracting agencies, and establishing a project development/financing facility.

The PPP Act specifically permits direct procurement in cases "where the circumstances do not allow for the use of competition." However, the details of the implementation arrangements in such cases have yet to be fully defined. Independent originators may, under certain limited circumstances, approach the authority with a project concept that meets the authority's objectives. Although it may be necessary to enable unsolicited proposals in limited circumstances, it is also essential to provide detailed guidance and to incorporate competition into the process to the fullest extent possible as required by the Act.

The PPP Act has also not been applied in all projects, highlighting the need to urgently harmonize this act with other laws within sectors. This is the case for the projects in the electricity sector where the Electricity Act allows for private participation and establishes the Electricity Regulatory Authority the role of receiving and processing applications for licenses for the generation, transmission, distribution or sale of electricity. Most of the existing Independent Power Producers have been given licenses under this act.

In addition, the PPP Act 2015 contains weaknesses related to dispute resolution, particularly during the procurement process of the private sector partner. The Act establishes procedures for the settlement of disputes related to the implementation of the PPP, but it does not establish procedures for the settlement of disputes arising during the procurement process. Therefore, the parties can only resort to traditional means of dispute resolution resulting in delays impacting the PPP process. It would be useful to establish a PPP Petitions Committee or tribunal to resolve such conflicts within the shortest time frame possible.

Issues related to land ownership, acquisition and compensation processes remain a major constraint on the development of infrastructure in Uganda. In the past, there have been difficulties in transferring the ownership of land from one entity to another on account of overlapping and conflicting land rights, lack of effective institutions capable of managing land transactions, and non-existent or weak markets that do not facilitate the transfer of land ownership at the appropriate price.[20] With most land in Uganda being under the customary tenure system, challenges related to the acquisition of this land used for infrastructure development projects persist, especially for large areas of land for sizeable development projects. The law provides for payment of compensation prior to the taking of possession; and a right of access to the courts for persons aggrieved by the decision. There exist challenges relating to the acquisition of right of way resulting into delays and raising the cost of the projects through compensation costs incurred in acquiring the land. This often delays the completion of the projects. For instance, there was delay in the construction of the Kampala-Entebbe Expressway due to disagreements between Uganda National Roads Authority and an owner of a property along the road who demanded UGX 48 billion in compensation, despite the fact that the UNRA had valued the property at UGX 4 Billion.

[20] World Bank; 2015. Uganda Economic Update 6th Edition, "Searching for the "Grail": Can Uganda's Land Support its Prosperity Drive? September 2015, Washington DC

While the Land Acquisition Act allows the Attorney General to apply to the High Court to have the money deposited with the court in an escrow account, this provision has not been enforced or applied.

The Government is proposing to amend the Land Act and certain articles of the Constitution to ease the acquisition of land to facilitate the achievement of national development objectives. Concurrently, the Presidential Commission of Inquiry has been recently instituted and tasked with reassessing the effectiveness of land laws as these laws relate to the processes of land acquisition, administration, management and registration. In order to prevent disputes arising from the value of compensation from stalling construction projects, the revision of the law should consider allowing the government to proceed with the implementation of the project after the disputed amount has been paid into an escrow account This should be done while the issues of valuation are discussed and adjudicated upon. The law should also forbid the transfer of ownership of land for which a notice of acquisition has been issued in order to curb the transfer of land to speculators.

4.2 Second prerequisite: The availability of long term finance

The availability of long-term finance is essential for the effective implementation of PPPs. This is because infrastructure projects almost always involve long-term timeframes, with contracts usually running for periods of 20 years or more. Thus, the private sector must have access to finance for similar periods. Without access to long-term funding in the domestic market, a project sponsor will generally seek financing from the international market, borrowing in foreign currency (usually US$), creating significant foreign exchange risks. In addition, in the aftermath of the financial crisis, international markets have also tightened. Banks are increasingly tightening liquidity in the case of emerging markets and shortening the periods of maturity for the financing that they make available.

Thus, it is necessary to identify sources of long-term *local currency* financing for the development of infrastructure. Crowding in local investors minimizes foreign exchange risks and provides opportunities for domestic investors to finance locally. At present, however, local banks generally impose even stricter liquidity and maturity conditions than do international banks. The most promising source of long-term local financing comes from institutional investors, such as pension and insurance funds.

The availability of long-term funding is extremely limited in Uganda, reflecting shallow financial and capital markets and the lack of the appropriate legal and regulatory frameworks to support its provision. The provision of long-term finance requires the presence of financial institutions with committed long-term horizons and the availability of a spectrum of financial instruments. However, these institutions and instruments are missing or underdeveloped in Uganda. In particular, Uganda's banking sector has only a limited ability to offer long-term funding.

The most sustainable sources of long-term capital in Uganda are the assets held by pension and insurance companies. But they are not being utilized to their full potential, with the role of institutional investors such as pension funds and insurance companies remaining undeveloped. On one hand, the insurance sector is still too small to play an active role in the activation of long-term finance, as the market mostly consists of general insurance and little in the way of life insurance and other savings products. On the other hand, while the National Development Plan (NDP) for 2010/11-2014/15 and the Vision 2040 prioritize reforms to the pension sector as a means to develop the financial services industry and the supply of long-term finance in Uganda, in practice, little progress has been made with reforms that would support this sector in playing a more significant role,[21] with coverage remaining at only 2 percent of the population.

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[21] World Bank, 2014; Uganda Economic Update 4th Edition, "Two Birds with One Stone — Reducing Vulnerabilities to Growth and Old-Age Security through a better Pension System", Washington DC

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Box 3: Institutional Investors and Infrastructure Finance

In Latin American countries such as Peru and Chile, the relatively developed capital markets and the presence of a number of institutional investors, such as pension funds, made it possible to issue project bonds or to structure other securitized instruments to meet these institutions' needs (i.e. for investment grade instruments). Guarantees provided by monoline insurance companies assisted this model prior to the 2008 Global Financial crisis, but issuance has dried up since their subsequent demise. In Asia, the central provident funds, such as the EPF in Malaysia and the CPF in Singapore, have been active providers of long-term finance for infrastructure and other development projects. South Africa's Public Investment Corporation is an example of an independent, specialist fund manager, with this entity making investments on behalf of other institutions, including pension funds, and including through the establishment of regional infrastructure funds. In regions with very limited capital markets and investors, governments and MDBs have had to act as the issuers or backers of instruments to provide the necessary investment quality, both in terms of credit levels and in terms of building the confidence of other investors.

A clear project pipeline needs to be developed immediately to allow local banks and fund managers to invest in the capacity and expertise needed to assess and invest in infrastructure deals. Investments in infrastructure, particularly during the construction phase, have significantly different characteristics from the investments with which institutional investors have traditionally been involved. For it to be worthwhile for institutional investors to build the necessary expertise and capacities required to participate in PPPs, either in-house or through cooperation with specialist partners and asset managers, it must be clear to them that a pipeline of projects exists. Therefore, it is the Government's role to develop this pipeline.

In the future, opportunities for such partnerships could arise for Uganda either by refinancing existing projects or financing new ones. The financing of new projects (such as toll roads) could be facilitated by establishing infrastructure debt funds, as the successful experience of Columbia indicates. It may be possible for institutional investors to partner with local commercial banks and /or international banks with a presence in Uganda and thereby to draw on their experience to structure such deals. Existing projects in the energy sector could be refinanced, with bank loans being rolled over into project bonds. The NSSF and other pension funds could then invest in these bonds, freeing up bank capital to invest in new projects.

Significantly, Uganda already has an established regulatory framework for the issuance of project bonds. The Asset-Backed Securities (ABS) regulation issued by the Capital Markets Authority (CMA) allows for the issuance of bonds of this type. This should facilitate the standardization of approval procedures and reduce the complexity and time involved in raising finances. The pension scheme investment regulations also allow for investment in infrastructure assets, with URBRA open to discussions on how to facilitate well-designed financial instruments. The NSSF would also welcome investment in well-structured instruments.

As Uganda develops its financial and capital markets, it is likely that it would still require the backing of sovereign and multilateral development banks (MDB) to engage in term financing. Subsidies may be required to ensure the commercial viability of projects. Guarantees and other credit enhancement mechanisms may also be needed to provide acceptable risk/return profiles for financing vehicles. Deals need to be specifically structured with institutional investors in mind. Thus,

[22] World Bank, 2014; Uganda Economic Update 4th Edition, "Two Birds with One Stone — Reducing Vulnerabilities to Growth and Old-Age Security through a better Pension System", Washington DC

engaging these institutional investors early in the project preparation process is essential. The African Development Bank (AfDB) issued a 10-year bond in 2012 to fund infrastructure and other projects in Uganda, with these bonds being acquired by NSSF. This demonstrates one manner in which multilateral banks can support countries to mobilize long-term finance.

With Uganda's membership in the EAC, there could be opportunities for it to leverage long-term financing from institutional investors within the EAC. For example, if attractive infrastructure bonds were offered in Uganda, pension schemes in Kenya and Rwanda could invest in them. Pension fund investment regulations in several EAC countries recognize regional investments as being in the same category as domestic assets, increasing the pool of potential institutional investor capital.

4.3 Uganda's Experience with PPPs: Mixed results emphasize the need for closing the gaps in the frameworks

In terms of the implementation of PPPs, Uganda has had a mixed record, with moderately positive outcomes in the energy sector in particular. Following the liberalization of the energy sector, a number of public private arrangements were initiated to support the newly separated roles of generating and distributing electric power. In the area of distribution, the UMEME concession was initially partnered by Globeleq of CDC, UK, which held 56 percent stake, and ESKOM, with 44 percent, before ACTIIS took over 100 percent ownership in 2009. Following an initial public offer in October 2012, UMEME is now fully divested to various local and international shareholders, including NSSF. Accounting for more than 75 percent of the distribution network in the country, UMEME's most significant achievement has been to improve the degree of efficiency in the distribution of power. Since UMEME has been involved in distribution, there has been a reduction in system losses from 38 percent to less than 20 percent over a period of 10 years; an increase in sales revenue collection from 65 percent to 98 percent; and improved access to power in the serviced area. Additionally, it generated tax revenues to a value of US$ 24 million (corporate) and US$ 33 million (VAT) in seven years; paid fees to a value of US$ 110 million in seven years; and made investments to a value of US$ 100 million over the same period. During a period when shortcomings in the distribution of electricity and the increased cost to the Government through subsidies to keep the cost of power affordable to the public were most significant, Parliament threatened to cancel the concession. The Parliament noted that there were flagrant illegalities and manipulations in the procurement of the concession and in the power distribution agreement, according to which the Government committed to increasing tariffs every quarter across all categories of power consumption.

In the electricity generation sector, Uganda has engaged in a number of IPPs. These have included ESKOM's 20-year concession to manage existing power stations, Kira and Nalubaale, on behalf of UEGCL; and Kakira Sugar's work on the 52 MW Bagasse power plant; on the Jacobsen Uganda Limited 50MW thermal plant; and on the Bujagali Hydroelectric Power Project, one of Uganda's flagship electric power generation projects. These arrangements have supported the Government's objective of increasing the supply of electricity to meet the rapidly expanding demand. Nonetheless, the level of access to and the cost of power remain problematic. This has raised questions related to the structure of these contracts, including the method of establishing tariffs, which allows for the pass-through of all costs to the tariff, thereby skewing the risk allocation in favor of the investor and increasing the exposure of consumers and the Government. There are also issues related to high and uneven tariffs. The Government is currently considering various options to restructure the financing of these projects so as to reduce the costs and to ensure more affordable power (see Box 6).

Box 6: Bujagali Hydroelectric Project PPA

The Bujagali Hydroelectric Power Plant Power Purchase Agreement (PPA) is a 30-year old availability-based agreement between Bujagali Energy Limited (BEL) and the Uganda Electricity Transmission Company Limited (UETCL) to generate power from a 250MW run-of-the-river hydro power project on the river Nile. This agreement became effective in August 2012. The total cost of the project, amounting to US$ 798 million, was raised through equity by Sithe Global (a Blackstone portfolio company) and a consortium of AKFED, IPS Kenya and Jubilee Insurance (all AKFED Group companies), which accounted for 22 percent of the total financing. The remaining 78 percent of financing was borrowed from a group of financiers including IFC, EIB, AfDB, FMO, DEG, KfW, Proparco, AFD and four commercial banks (Absa, BNP Paribas, SCB and Nedbank) under a Partial Risk Guarantee cover.

Allocation of responsibilities and risks: The PPA allocated the responsibility for operating and maintaining the dam project, the construction of which had just been completed, to BEL, so long as the river was running. BEL was also responsible for securing equity financing, with the larger component of financing being the responsibility of the Government, which borrowed the funds from various funding agencies. The Project's dispatch is determined by UETCL on the basis of Uganda's power needs and ability to release water from Lake Victoria. The hydrology risk is borne by the off-taker, UETCL.

Repayment: Costs are fully recoverable. The Project's tariff is structured as a capacity payment only, intended to cover the Project's ongoing costs (mostly debt service, equity returns and O&M), with these adjusted only if availability targets are not met. The PPA included a 5-year tax holiday that was intended to support cost recovery.

Achievements: The Project has been operating satisfactorily, with an average availability of 98 percent, with an average capacity factor of 66 percent, and all payments from the off-taker made on time. The Project currently generates approximately 45 percent of the total power generated in Uganda, closing the major electricity deficit that existed in the period from 2007 to 2012 due to weak generation capacity at the time. The plant's annual production is 16 percent higher than the estimates. Uganda Electricity Distribution Company Limited has covered a much larger population than anticipated. The project has added substantially to existing installed capacity and energy to the national grid; reduced power shortages; and improved service reliability. Despite the cost increases, it was much better than the alternative of high-cost thermal generation which costed about US¢ 20-25/kWh.

Challenges: The project was commissioned 11 months behind schedule and at higher than estimated cost. In alignment with the EIB's procedures—the EPC's bids were made public at their opening. In a situation of limited competition and a large difference in bidding prices, the EPC price increased by US$90 million (19 percent) during negotiations. BEL has a high tariff structure, due to the relatively high project cost (US$ 3.6 million/MW) and a very short debt amortization schedule of 11 years, ending in 2023. The project tariff stands at US$ 0.106 per kWh. After the expiry of the tax holiday in August 2017 and with an accelerated depreciation of the dam assets being claimed by BEL, the tariff is expected to rise to about US$ 0.147 per kWh beginning August 2017, increasing to US$ 0.159 per kWh by 2023, as debt repayments commence. This could render the Government's objective of providing affordable access to electricity void, with direct adverse effects on the Uganda's competitiveness and growth. The tariff will further increase to US$ 0.159 per kWh in 2023 as debt repayments commence, thereby increasing the outlays for debt repayments.

Response: Adjusting the PPA parameters of the PPA arrangements could help ensure the project meets its objectives. The Government has proposed to reduce the Project's tariffs, while respecting the current contractual structure by extending the Corporate tax holiday; refinancing the loans to extend maturities, along with possibly demanding for additional equity; and increasing the capacity factor of Bujagali Project from 66 percent (for 2015) to 84 percent, particularly if industrial demand during off-peak hours could be increased.

Uganda's experiences with PPPs in the transportation sector have so far been underwhelming. Uganda initially engaged in PPPs in the railway sub-sector, followed more recently by the road sub-sector. The 25-year Rift Valley Rail joint concession for the operation of railway in Kenya and Uganda was launched in 2006, with this concession being intended to facilitate the construction and provision of railway services to link Kampala to Mombasa. After 10 years, this concession

does not appear to have fulfilled its obligations. In particular, it appears to have failed to meet quality specifications and safety standards and to have defaulted on the payment of concession fees. Although the concession recorded positive early results, including a 60 percent increase in operating efficiency and 80 percent reduction in inland cargo transit time to Kampala, the concession had to be restructured because the SPV failed to meet its financial obligations. Thus, the Government communicated its intention to terminate the concession. It has been argued that the structure of the concession, which bundled the network and rolling stock into a single concession, and the initial choice of concessionaire were the principal causes of the failure of this PPP arrangement. There have been no other closed PPPs in this sector. This experience underscores the importance of building coherent frameworks to support the appropriate identification, preparation and oversight of projects to minimize the risk of projects falling into distress or being cancelled. A major PPP in the pipeline, the first transport sector project following the rail concession involves the Kampala-Jinja Expressway Project, which is currently at the feasibility stage (see Box 7).

The most significant challenge within the road sector relates to whether tolls will be able to generate the required income to service the payments. Uganda's experience with the use of tolls lies in the distant past, more than 20 years ago, for vehicles transiting the Kampala-Masaka road. Without a toll policy to set the framework for tolling, the system faced a number of challenges until it was disbanded. The draft toll policy, now resting with Cabinet for approval, will be crucial for closing this gap if and when road tolls are reintroduced. Initial studies on consumers' willingness to pay suggest a level of UGX 70 per kilometer, which is perhaps too low to service the contractual payment obligations. A detailed willingness-to-pay and affordability analysis is currently being conducted to inform the Minister of Works and Transport on the appropriate toll levels to be introduced on the toll roads. A roads bill, which is pending parliamentary approval, will provide the legal framework for tolling on Uganda's toll road network.

Box 7: Kampala-Jinja Expressway

The Kampala-Jinja Expressway PPP is expected to be a 30-year greenfield design, build, finance, operate and maintain arrangement for a 77 km mainline from Kampala to Jinja and an 18km bypass to the south of Kampala city, costing about US$ 1 billion. As an alternative to the existing highway, it is expected to result in a high level of efficiency to both the national road network and to the East African transport corridor that provides the primary gateway for the flow of goods between Kenya and Uganda and neighboring Rwanda, DRC and South Sudan. A whole life arrangement to operate and maintain the expressway is being considered. In May 2014, the IFC was mandated by the Uganda National Roads Authority (UNRA) as the transaction advisor for the development of the Kampala-Jinja Expressway under a PPP arrangement.

The feasibility study considered the allocation of key project risks as follows:

(i) *The financing risk is expected to be shared between the Government and the private partner*. The project will be financed through debt and equity. Three development partners, the European Union (EU), Agencie Francaise de Developpement (AFD) and the African Development Bank (AfDB), will provide up to US$ 500 million to the Government to close a viability gap to buy down project capital costs. The residual funding needs for the project's construction and operation will be provided by the private partner. The partner selected to design, build, finance, operate, maintain and transfer the expressway to the Government is expected to be procured through an international competitive bidding process.

(ii) *The delivery of the project's right of way is a risk fully borne by the Government of Uganda*. Access to land for such large projects is associated with a high degree of risk in the case of infrastructure projects in Uganda. Similarly, the scale and complexity of the land acquisition and resettlement program for the Kampala-Jinja Expressway makes land acquisition a major risk to this project. The Government, through UNRA, is committed to developing the Resettlement Action Plan in accordance with IFC Performance Standards.

(iii) *Construction could involve delays that would result into cost overruns and time delays*. This risk is

expected to be fully borne the private partner.

(iv) *The private partner will bear all risks associated with operating and maintaining the expressway in accordance with pre-agreed standards*.

(v) *The Government will bear the demand risk*. The project structure under consideration by the PPP Committee is an availability-based payment mechanism with all the collected tolls being used by the Government to meet availability payment obligations. Any shortfalls or surpluses related to the agreed availability payment are a risk borne by the Government. Revenues for the repayment of debt are based on a proposed toll road rate for which the value proposition to those willing to pay the road toll is time savings, vehicle operating cost savings and a safety premium.

(vi) *Forex risk is expected to be shared between the private party and the government.* This is a key risk and irrespective of who bears it, it needs to be clearly assessed.

Uganda has expanded PPPs to several other sectors of the economy, the vast majority of which are contracted at the national level. In addition to arrangements in the transport and energy sectors, Uganda has a number of PPP arrangements within the tourism and the telecommunications sectors, and for the construction and operation of office buildings and accommodation. The vast majority of PPPs are still conducted at the national level, given the limited capacities and limitations on borrowing by sub-national governments.

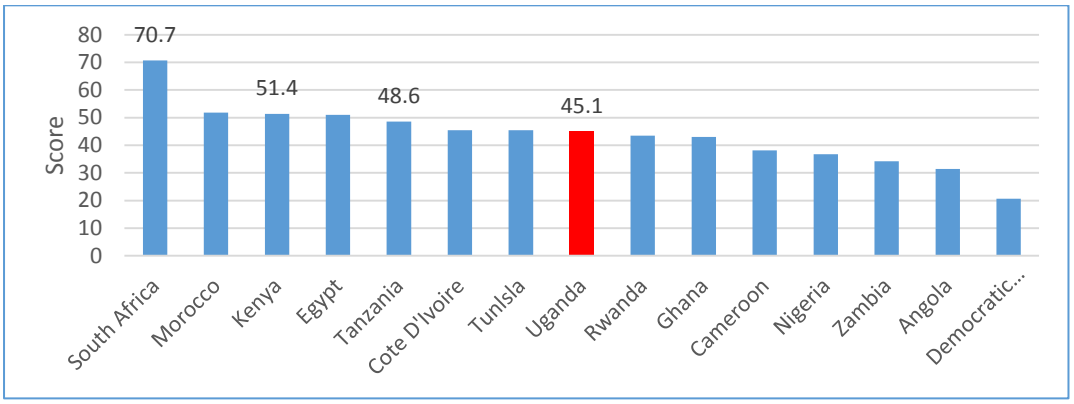
Uganda has an emerging pipeline of projects which need project development funding and technical, financial, and legal expertise in order to ensure that they are market ready. The Government is taking a number of steps to mobilize funding to develop its frameworks and projects by tapping into grant funding from bilateral and Multilateral institutions, including DFID, PPIAF, the World Bank, the African Development Bank, the European Union and others. Some local governments are currently engaged in small projects with private sector participation, which may or may not qualify as PPPs. Others, such as Kampala Capital City Authority, Entebbe Municipality and around six sub-national governments have received assistance from the World Bank that could enable them to engage in PPPs after they have developed sufficient capacities. It will be important to consider amending the PPP act to specifically allow local governments to participate in PPPs. This should be followed by appropriate guidelines and regulations specifically for local governments.

Overall, even with a recently developed formal PPP framework, Uganda still needs to put effort in closing the implementation and remaining regulatory gaps. A number of these gaps arise from the fact that some PPP projects were initiated long before the formal framework had been established. Thus, they were arranged on an ad hoc basis, which may have resulted in a failure to address a number of critical issues. Others have arisen because of the gaps in implementation and in legal frameworks. For example, weaknesses in project design have arisen from a failure to ensure that project implementation has been preceded by comprehensive feasibility assessments. They have also arisen from the lack of standard treatment for proposals, whether solicited or not, with many unsolicited proposals being based on feasibility studies conducted solely by the private sector and thus not necessarily capturing key risks for government; and from insufficient capacities within MDAs to appraise projects and to successfully facilitate negotiations related to PPPs, and the associated procurement, implementation and management of contracts. Many of these issues emanate from the weaknesses in the overall public investments management processes in Uganda.[23] Developing a project as a PPP takes longer and costs more compared to projects involving traditional procurement. These projects also require a detailed assessment of known and contingent risks to ensure the affordability, bankability and sustainability of the project. However, some of these processes are still missing in the case of projects in Uganda.

[23] World Bank (2016), Uganda Economic Update. 7th Edition. From Smart Budgets to Smart Returns: Unleashing the power of public investment management. April 2016. Washington DC.

The gaps in the framework and implementation become clear when Uganda is compared with peers. According to the Benchmarking Public-Private Partnerships Procurement 2017 study,[24] Uganda falls behind Kenya and Tanzania in terms of the maturity of procurement processes related to PPPs, although it is ranked higher in terms of processes for the management of contracts. Kenya and Tanzania's superiority seems to be linked to the better embedded frameworks and good practices in these two countries and an earlier adoption of a PPP Law and a structured PPP program. Kenya, in particular, scores higher in terms of its ability to prepare projects, given the implementation of best practices over the last 4-5 years under a World Bank lending project dedicated to the development of PPP frameworks and projects. The assessment also matches that of the Economist Intelligence Unit (EIU) evaluation conducted in 2015, which ranked Uganda in eighth place out of 15 countries surveyed in Africa (See Figure 12). However, Uganda scores better than either Kenya or Tanzania in terms of its PPP contract management practices This is very encouraging, implying that Uganda has the potential to build up its structured program faster than either Tanzania or Kenya. Uganda also seems to have much greater fiscal space to increase PPPs in the near future, given its relatively low debt to GDP ratio.

Figure 11: Uganda fares modestly in Africa's Infrascope Ratings



Source: Economist Intelligence Unit, 2015 "Evaluating the environment for public-private partnerships in Africa; The 2015 Infrascope.

5. Creating the conditions necessary for Uganda to maximize benefits from PPPs

The fore-going discussion underscored the challenge Uganda faces in closing the massive financing deficit. This deficit arises from the need to provide infrastructure and social services crucial for the country's social and economic transformation. With the infrastructure deficit large and expected to increase in the medium term, the traditional financing instruments are clearly insufficient to bridge the profound gap between existing public resources and financing requirements. By leveraging synergies between the public and private sectors, PPPs can mobilize additional sources of finance to fund the development of vitally needed infrastructure; to deliver on budget and on time to a greater extent than in the case of publicly financed projects; and to deliver higher quality services than in the case of publicly managed projects. Uganda has already started using PPPs and National Development Plan identifies PPPs as a key instrument to attract new investment and to deliver infrastructure more efficiently. Uganda has also already put in place an excellent

[24] The Benchmarking PPP Procurement assessment measures government's capabilities to prepare, procure, and manage PPPs, as well as the procedures for evaluating unsolicited proposals, across different countries. It can be found at http://bpp.worldbank.org/data/exploreindicators/PPP-procurement.

legal and regulatory framework. The promulgation of the PPP Act in 2015 placed Uganda in the same league as South Africa and Kenya in terms of the legal frameworks required to support PPPs. However, much still needs to be done to ensure the appropriate and effective implementation of these frameworks. To implement a successful PPP program, Uganda must constantly seek guidance from the lessons of her own experience with the various projects it has implemented, combined with best practices from other countries. In summary, there are six key lessons that must be at the forefront of action in facilitating changes necessary to implement successful PPPs[25].

First, the selection of projects must be done well. Selection of PPP projects should involve careful analysis to verify that a project is likely to be feasible; to be attractive to the private sector; and to provide value for money. PPPs are not a panacea and many projects are not suitable to be implemented as PPPs. In particular, there are problems that PPPs cannot solve. For example, by itself, the establishment of a PPP will not reform a sector with substantial governance and pricing problems. Where such problems exist, it is necessary for the Government to diligently implement sector reforms as part of the process of establishing PPP projects.

Second, a sound institutional and regulatory framework is critical for the success of PPP programs. While Uganda has already put in place a legal framework through the promulgation of the PPP Act 2015, it must strengthen the corresponding PPP institutions to implement this Act. In addition, it would need close the gaps identified, including streamlining the processes with the laws within sectors, such as the Electricity Act and to specifically allow local governments to participate in PPPs.

Third, successful PPP programs allocate appropriate resources necessary for project preparation. Once projects are selected, the necessary financial and human resources should be assigned to carefully prepare projects through budget allocations and other funding sources. The Government has relied excessively on studies and analysis provided by investors and other governments, despite the potential for conflicts of interest. Global good practice indicates the importance of independent feasibility studies and transaction advice from independent and highly experienced advisers to identify investors and financiers and to assist in the oversight of implementation.

Fourth, competition is critical. Best practice PPP programs adopt open, transparent, competitive bidding. Competition brings the best out of private investors and helps to ensure that the Government achieves value for money. It also protects against perceptions of corruption and bias that may result in the case of direct negotiations and unsolicited proposals. Thus, direct negotiations and unsolicited proposals should be permitted only in the most limited of circumstances, when this is the only feasible approach. The PPP Act mandates this approach, and it should be implemented accordingly.

Fifth, the use of public support must be carefully thought out and guided by a clear and transparent approach. Global good practice demonstrates the need to allocate sufficient financial and human resources to assess, approve, and monitor public liabilities associated with PPP. Uganda needs to adopt and apply a policy for the provision of Government financial support for PPP, including awarding guarantees and deciding which projects will receive such support.

Sixth, building capacity through solid training programs for staff involved in PPPs at different levels of government. This has to be complemented with a public outreach campaign. This capacity building program plays an important role in enabling government staff, local governments and the public to understand the rationale for PPPs. Training will enable Government staff to select the appropriate projects for PPP and to implement those projects well. In addition, an awareness campaign should be implemented to ensure that the public understands the value and risks associated with

[25] World Bank 2016, Tanzania Economic Update. The Road Less Travelled: Unleashing Public Private Partnerships in Tanzania. May 2016.

PPP. In addition, it is necessary to strengthen the local financial sector to develop the skills and instruments needed to support PPP.

Building on these lessons, the immediate major areas of action for Uganda are as follows**:**

(i) **To maximize the value derived from its investments through PPPs and to manage the associated risks, Uganda needs to immediately establish the appropriate institutions to actualize the existing legal and policy frameworks.** The frameworks within the PPP Act in 2015 need to be implemented for Uganda to conform to global good practice for the management PPPs. This entails creating capacity within the central PPP unit and the potential contracting authorities to enable them to prepare, appraise and provide oversight for projects. The PPP screening process must be well-coordinated with the overall Public Investment Management (PIM) process so that only economically feasible investments that show promise as PPPs are taken up for further detailed studies. It also requires establishing methodologies for detailed feasibility analyses, including value for money assessments and fiscal affordability assessments; streamlining the procurement processes, including adding greater detail and competition into the process for unsolicited projects; establishing robust contract management processes; and establishing robust fiscal risks assessment both at the national level and at the project level.

(ii) **Uganda's PPP program needs to be appropriately resourced to enable it to provide stronger leadership and direction, and for funding project preparation, providing viability support and a liquidity reserve to backstop any contingent liabilities.** The Government of Uganda needs to urgently set up the Project Development Facilitation Fund (PDFF). This will entail mobilizing budgetary and non-budgetary resources, including from bilateral and multi-lateral donors. Revenue flows from projects, including success fees, can be other sources of revenue for such fund. It will also entail setting up the governance and operational framework for the functioning of the fund.

(iii) **Uganda should work towards building a robust PPP pipeline**. There are several project ideas especially in the road, energy, residential and commercial accommodation and other sectors which should be screened from the investment and PPP perspectives. It is essential to move these projects forward, including through the development of a sustained project development funding mechanism in the form of the PDFF and to tie these projects to efforts on developing innovative financing mechanisms.

(iv) **As a priority, Uganda ought to use innovative means to mobilize local long term finances to improve the environment for PPPs, particularly the risk to foreign currency exposure.** For countries such as Uganda, where the domestic financial markets and capital markets are still limited, financing for PPPs and options for credit enhancement are biased towards foreign sources, which in turn makes the foreign currency exposure a key risk for investors. As the Government expedites the development of the pension sector and implements the Capital Markets Master Plan, it should also make efforts to mobilize domestic currency financing through the establishment of syndicates of commercial banks and large surplus institutions such as pension funds, particularly the NSSF, to finance PPPs. The Government needs to take steps to encourage and facilitate the listing of SPVs. It may also be essential to work through multilateral arrangements and to raise project bonds which domestic surplus funds institutions such as NSSF could subscribe to. Alternatively, the Government should strive to create a debt vehicle to encourage pension funds and commercial banks to invest in these projects.

(v) **It is essential for Uganda to incorporate the principles of transparency and accountability to allow better citizen engagement and involvement in decision-making.** Key information related to both operational and pipeline projects at various stages of preparation and procurement should be placed in the public domain in a timely manner to increase the predictability of Uganda's PPP program. Public scrutiny is likely to incentivize government to adopt transparent and accountable processes, consequently stimulating investor interest and stakeholder

support for PPP as a modality of asset creation, operation and management, and efficient and effective service delivery. Therefore, a communication strategy should be developed for the PPP program to sensitize both internal and external stakeholders and to engage them in dialogue through a higher level of stakeholder engagement and better disclosure policies. A structured communications program would ensure that prospective investors, contracting authorities and the general public are aware of the salient features of the PPP Act and the processes to be followed for projects, including processes related to procurement. It would also ensure that the Government's pipeline and priority areas for PPP are fully visible.

Statistical Annexes

Table A1: Key Macroeconomic Indicators

Indicator	Unit measure	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Population	Millions	31.0	31.9	32.9	33.9	34.9	39.9	41.1
GDP	USD millions	20,181.4	20,262.5	23,237.3	24,993.0	27,761.0	27,531.0	24,661.0
Per capita GDP	USD	578.9	562.4	652.0	670.0	709.0	690.0	600.7
GDP growth	%	5.2	9.7	4.4	3.3	4.5	5.1	4.8
Gross Domestic Savings	as % of GDP	19.7	19.5	17..7	21.7	19.9	21.9	24.3
Gross Investments	as % of GDP	12.5	12.3	28.2	29.5	29.0	31.5	24.3
Inflation (period average)	%	9.4	6.5	23.4	5.8	6.9	2.7	7.7
Exchange Rate (end-year)	UGX/USD	2,283.3	2,623.2	2,484.4	2,630.6	2,599.7	2,918.8	3,102.5
External Sector								
Exports - Goods and Services	Million USD	3,470.1	3,828.6	4,698.3	5,051.5	5,048.6	4,974.3	5,696.7
Imports - Goods and Services	Million USD	-5,757.2	-6,839.9	-7,684.4	-7,579.3	-7,745.4	-7,965.6	8,730.0
Current Account Balance	Million USD	-1,631.0	-1,984.0	-2,219.0	-1,582.0	-2,105.0	-1,971.0	-1,452.0
Balance of Payments (overall balance)	Million USD	235.0	-597.0	759.0	534.0	313.0	422.0	708.0
Gross Foreign Reserves	Million USD	2,384.7	2,044.0	2,643.8	2,912.3	3,394.0	2,895.0	2,962.0
External Debt	Million USD	2,343.4	2,904.9	3,067.3	3,749.0	4,386.2	5,093.2	5,154.1
Foreign Direct Investment	Million USD	693.0	719.0	1,244.0	940.0	1,096.0	870.0	512.0
Monetary Sector								
Average Deposit Rate	%	2.0	2.1	3.2	3.0	3.1	3.3	3.2
Average Lending Rate	%	20.7	19.8	24.6	24.8	22.1	25.2	23.7
Growth in Money Supply (M3)	%	23.6	25.7	26.1	17.4	15.7	16.6	15.2
Government Finance								
Total Domestic Revenue	as % of GDP	10.5	13.6	11.2	11.3	11.6	13.0	13.5
Tax Revenue	as % of GDP	10.3	13.4	11.0	11.0	11.4	12.7	12.9
Non Tax Revenue	as % of GDP	0.3	0.2	0.2	0.3	0.2	0.3	0.6
Grants	as % of GDP	2.1	1.9	1.9	1.4	1.0	1.2	1.4
Total Expenditure and net lending	as % of GDP	16.7	19.1	15.6	16.2	16.6	18.5	19.7
Recurrent Expenditure	as % of GDP	10.5	12.7	9.1	9.0	9.5	9.9	10.8
Development Expenditure	as % of GDP	6.1	6.1	6.1	6.5	7.0	6.7	7.0
Fiscal Balance (overall)	as % of GDP	-4.0	-3.6	-2.5	-3.5	-4.0	-4.3	-5.2

Table A2: Growth and Structure of the Economy

Economic Activity	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Real GDP Growth Rates (%)	**5.2**	**9.7**	**4.4**	**3.3**	**4.6**	**5.1**	**4.8**
Agriculture	3.2	2.9	1.1	1.8	3.0	3.0	2.6
Industry	7.8	11.4	3.0	4.4	3.9	7.9	3.1
o/w manufacturing	4.5	7.8	2.7	-2.5	2.2	11.0	0.4
o/w construction	12.5	15.0	3.9	10.8	5.3	2.7	5.8
Services	5.9	12.4	3.9	4.1	4.3	5.3	6.8
GDP Shares (% of constant GDP)							
Agriculture	26.2	24.6	23.8	23.5	23.1	22.6	22.1
Industry	18.1	18.4	18.2	18.4	18.2	18.7	18.4
o/w manufacturing	8.5	8.4	8.2	7.8	7.6	8.0	7.7
o/w construction	5.8	6.0	6.0	6.5	6.5	6.3	6.4
Services	48.5	49.7	49.9	50.3	50.2	50.2	51.2
FISM and net taxes	7.2	7.3	8.1	7.9	8.1	8.1	0.0
GDP Shares by expenditure type (% of nominal GDP)							
Final Consumption Expenditure	83.2	84.2	86.6	82.2	83.0	86.7	92.9
Households	73.8	74.6	73.9	74.4	74.8	77.8	82.7
Government	9.4	9.6	12.7	7.9	8.2	8.9	10.2
Gross Capital Formation	27	27	28	27	26	23.9	26.5
Gross fixed capital formation	26.6	26.5	28.1	27.1	25.9	23.5	26.1
Charges in inventories	0.4	0.3	0.3	0.4	0.4	0.4	0.4
Net exports	-10.1	-11.0	-15.1	-10.1	-9.8	-11.1	-11.4
Gross domestic saving (% of GDP)	12.5	12.3	17.7	21.7	19.9	21.9	24.3
Public	2.9	3.3	2.4	3.1	1.4	1.5	2.3
Private	9.6	9.0	15.3	18.6	18.5	20.4	22.0

Table A3: Central Government Fiscal Framework (% of GDP)

Item	Outturn	Outturn	Outturn	Outturn	Outturn	Outturn	Outturn	Outturn		
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17est.	2016/17 Budget
Revenues and Grants	13.5	12.7	15.5	13.1	12.8	12.6	14.2	14.9	15.9	16.2
Revenues	11.0	10.5	13.6	11.2	11.3	11.6	13.0	13.5	14.0	14.4
URA	10.6	10.3	10.9	10.3	11.0	11.4	12.6	12.8	13.3	13.6
Non-URA	0.4	0.3	0.2	0.2	0.3	0.2	0.3	0.6	0.6	0.7
Oil Revenues	-	-	2.5	0.7	-	-	0.2	0.1	0.1	0.1
Grants	2.6	2.1	1.9	1.9	1.4	1.0	1.2	1.4	1.8	1.8
Budget Support	1.5	1.1	1.1	1.0	0.3	0.3	0.3	0.4	0.3	0.3
Project Support	1.0	1.0	0.8	0.9	1.1	0.7	0.9	1.0	1.5	1.5
Expenditure and Lending	15.0	16.7	19.1	15.6	16.2	16.6	18.5	19.7	21.9	22.2
Current Expenditures	9.5	10.5	12.7	9.1	9.0	9.5	9.9	10.8	10.4	10.4
Wages and Salaries	3.4	3.2	3.5	3.1	3.3	3.4	3.5	3.5	3.6	3.6
Interest Payments	1.0	0.9	0.9	1.0	1.4	1.4	1.6	2.0	2.3	2.2
Other Recurr. Expenditures	5.1	6.4	8.2	5.0	4.3	4.8	4.8	5.2	4.4	4.7
Development Expenditures	4.8	6.1	6.1	6.1	6.5	7.0	6.7	7.0	9.7	9.8
Net Lending/Repayments	(0.2)	(0.1)	(0.1)	(0.1)	0.6	0.0	1.6	1.8	1.6	1.9
Domestic Arrears Repaym.	0.8	0.2	0.4	0.5	0.1	0.0	0.3	0.1	0.2	0.1
Overall Fiscal Bal. (excl. Grants)	(4.0)	(6.1)	(5.5)	(4.4)	(4.9)	(5.0)	(5.5)	(6.2)	(8.1)	-
Overall Fiscal Bal. (incl. Grants)	(1.5)	(4.0)	(3.6)	(2.5)	(3.5)	(4.0)	(4.3)	(5.2)	(6.0)	6.2
Financing:	1.5	4.0	3.6	2.5	3.5	4.0	4.3	5.2	6.0	6.2
External Financing (Net)	1.6	1.9	1.5	1.9	2.2	1.3	1.2	2.9	5.3	5.4
Domestic Financing (Net)	0.0	1.7	2.3	0.0	1.1	2.3	3.2	2.2	0.7	0.9
Errors and Omissions	(0.2)	0.5	(0.3)	0.6	0.2	0.4	(0.1)	(0.3)	-	-
Nominal GDP (Shs billions)	34504.0	40946.0	47078.0	59420.0	64758.0	70458.0	77845.0	84907.0	93939.0	92878.0

Table A4. Monetary indicators

	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Monetary Aggregates									
M3 as % of GDP	18.3	15.1	13.4	10.6	9.8	9.1	8.7	7.9	7.7
M2 as % of GDP	14.3	11.7	10.4	8.3	7.8	7.3	6.9	6.2	6.1
M3 growth rate (%)	25.0	23.6	25.7	26.1	17.4	15.7	16.6	15.2	24.4
M2 growth rate (%)	26.3	22.7	22.2	24.3	21.2	17.6	17.9	16.1	23.9
Domestic Credit									
Total domestic credit (% of GDP)	9.2	7.8	7.3	5.2	5.2	5.0	4.5	4.2	3.9
Private sector credit (% of GDP)	10.4	9.2	7.9	6.3	6.1	5.5	5.1	4.7	4.6
Total domestic credit growth (%)	64.1	52.4	50.6	32.7	27.8	19.7	17.8	27.9	25.7
Private sector credit growth (%)	31.3	30.7	26.8	21.5	23.9	18.6	17.3	17.0	
Interest Rates Structure									
Average TB rate (period average, %)	8.4	5.3	7.6	17.2	10.3	9.3	21.1	15.2	
Average lending rate (%)	20.9	20.7	19.8	24.6	24.8	22.1	25.2	23.7	
Average deposit rate (%)	2.1	2.0	2.1	3.2	3.0	3.1	3.3	3.2	

Table A5. Balance of Payments (percent of GDP unless otherwise stated)

Variable	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16 Est.	2016/17 Proj.
Current Account (incl transfers)	**-8.1**	**-9.8**	**-9.5**	**-6.3**	**-7.6**	**-7.2**	**-5.9**	**-7.1**
Exports of goods	11.5	11.3	11.4	11.7	9.7	9.9	11.0	**10.8**
o/w coffee	1.3	1.8	1.9	1.7	1.5	1.5	1.4	**1.5**
Imports of goods	-20.4	-23.1	-22.6	-20.1	-18.3	-18.1	-18.6	**-19.0**
o/w oil imports	-2.5	-3.4	-4.1	-4.1	-3.9	-3.4	-2.6	**-2.8**
Services (net)	-2.1	-3.4	-1.7	-1.6	-1.2	-2.5	-2.7	**-2.2**
Trade balance	-8.9	-11.8	-11.1	-8.5	-8.5	-8.2	-7.6	**-8.2**
Income (net)	-1.7	-1.7	-2.0	-2.1	-2.2	-1.6	-1.7	**-1.7**
Current transfers (net)	4.6	7.1	5.3	5.9	4.3	5.1	6.3	**5.1**
Capital and Financial Account	**8.8**	**5.3**	**10.1**	**6.1**	**6.5**	**4.2**	**4.2**	**7.2**
Capital account	1.0	0.8	0.8	0.1	0.3	0.4	0.5	**0.5**
Financial account	7.9	4.5	9.3	5.9	6.1	3.9	3.7	**6.7**
o/w direct investment	3.4	3.5	5.4	3.8	3.9	3.2	2.1	**2.1**
o/w portfolio investment	0.2	0.0	-1.1	-0.2	0.0	-0.6	-0.7	**0.1**
Overall Balance	1.2	-2.9	3.3	2.1	1.1	1.5	2.9	5.2
Gross International Reserves (million USD)	2,384.67	2,043.98	2,643.77	2,912.34	3,394.0	2,895.0	2,962.0	2,980.0
Gross international reserves in months of imports	4.4	3.2	4.3	4.5	5.1	4.3	3.6	4.2

Table A6. Inflation Rates (percent)

Item	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	FY	FY	FY	FY	FY	FY	FY	FY (Proj)	FY (Proj)
CPI (average)	14.2	9.4	6.5	23.7	5.8	6.7	2.7	7.7	5.2
CPI (end of period)	12.3	4.2	3.3	18.0	3.7	5.0	4.9	8	5.8
Food (end of period)	27.9	16.5	9.3	12.8	-1.4	7.2	6.1		
Core Inflation (end of period)	8.9	6.7	5.7	19.5	5.8	2.9	4.9	7.9	5.5