Uganda Economic Update, 11th Edition

Financing growth and development:

Options for raising more domestic revenues

FACTSHEET

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- **Uganda has potential to increase domestic revenues: Uganda collects 14 percent of Gross Domestic Product (GDP) in both taxes and nontax revenue, which is insufficient to finance its development.** Strengthening the tax system by reducing tax exemptions, broadening the tax base through tapping into hard to reach informal activities, and improving Uganda Revenue Authority (URA)'s systems could raise additional tax revenues to beyond 20 percent of GDP over the medium term.

- **Creating a robust social contract, achieved through effective service delivery and value for money from public investments, could enhance voluntary tax compliance:** Enhancing public awareness, transparency, and civil society engagement are crucial to increasing such compliance. Improved service delivery and public investment management are vital to demonstrate value for money, so that citizens have confidence in their taxes being well spent.

1. What is the outlook for the economy?

The outlook is positive following a better than expected recovery from the low growth outcome last year. We expect the economy to sustain this recovery, and GDP growth to continue rising and reach about 5.5 percent in FY2017/18. However, given the very high population growth, such economic growth rates, although sizable, are still insufficient to keep the country on track to attain middle income status.

2. What accounts for this positive outlook?

Good weather and a retraction of the army worm outbreak have contributed to output growth of 6 percent in agriculture. In the first half of FY 2017/18, exports grew at 12 percent, depicting strong external demand and a global economy that has been picking up. Private sector credit also grew at 5.5 percent during this period, despite the high cost of credit, as lending rates responded slowly to the sustained reduction in policy rates. Stable macro-economic conditions, underpinned by low inflation and a relatively stable exchange rate, and continued export demand could support further growth in private sector investment. Favorable weather, and better managed government investments in energy, roads and other oil-related infrastructure are also key to sustaining this growth outlook.

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3. What are the major risks to the outlook?

Economic growth could be slowed by bad weather, the impact of conflict in neighboring countries on export markets, delays in executing public projects, and lower than expected growth in private consumption. On the external front, sudden commodity price increases, especially of oil, and a reduction in foreign demand are risks to Uganda's exports and the growth outlook. If budget revenue targets are not met, this could also slow the ambitious government investment program due to limited alternative financing. In addition, Government could raise its borrowing from the domestic market, which might potentially crowd out the private sector and affect business activity and consumption.

4. Why should Ugandans care about domestic revenue mobilization?

Uganda collects about 14 percent of GDP in taxes and non-tax revenues annually, which is below the estimated potential for a country like Uganda of more than 20 percent. The bulk of these revenues are taxes. A government that cannot mobilize sufficient revenues cannot function well or provide essential services to its citizens, especially when foreign aid is declining. The high population growth rate is also putting immense pressure on public service delivery. The investments required for transformative infrastructure to address the binding constraints to growth, and support oil production, have increased the need for public spending and, hence, a required increase in domestic revenues to sustain growth and safeguard debt sustainability.


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5. What does Uganda's current tax system look like?

A good tax system should be fair and neutral to the business environment, and yield adequate revenues. At design, the Ugandan system met the basic tenets of a progressive and internationally comparable system. Over time, however, policy discretions (such as tax exemptions) have changed this landscape. Recent innovations which include online services; simplified procedures through a URA one-stop center for tax payer registration and assistance; and an independent tax tribunal are steps in the right direction.

6. What are some of the key challenges with the existing tax system?

The challenges are multi-faceted. Reform efforts tend to be opposed at many levels due to strong vested interests. Tax exemptions deny the country an estimated 4-5 percent of GDP in foregone revenue. The absence of a Tax Expenditure Governance Framework to systematically guide the process of introducing, monitoring and removing exemptions, means that exemptions should not be given unless they are addressing a clear market imperfection, such as a high cost of education in some areas, which could be reduced by exempting some inputs in the construction of schools in those areas. Other practices like the "deemed VAT"[1] innovation, though intended to ease cash flow challenges for investments in the oil sector or aid funded projects, have created tax administration challenges and potential foregone revenue. Similarly, although Personal Income Tax (PIT) contributes about 10 percent of total revenues, this is 30 percent less than many countries in the region.

1. Under this scheme goods which have not paid VAT are assumed to have paid VAT and suppliers of such goods are allowed to claim back all the VAT they paid on their inputs or purchases.

Uganda has a large informal sector, estimated to be employing over 80 percent of the labor force and producing 45 percent of GDP, but this sector transacts in cash, is largely not regulated, and evades registration by many authorities including URA. This, therefore, limits the percentage of the productive population and economic activity paying tax. Furthermore, within the formal sector, there are many that are exempted from tax, such as public officials in the security sectors and judicial services, allowances of members of parliament, and staff on technical assistance agreements. Professionals, such as lawyers, accountants, architects and doctors are also hard to tax or have a low compliance culture. Finally, the prevailing weaknesses in the delivery of public services do not only affect the quality of living and pace of development, but also the willingness and compliance of citizens to pay taxes.

7. How can Uganda raise more tax revenue?

We look at this in three ways: i) expanding the tax base by getting more entities to pay tax; ii) making sure that the tax instruments are improved to make them more efficient; and iii) raising efficiency of tax administration. The idea of expanding the tax base does not necessarily imply taxing more those who are already paying. Similarly, a more efficient system of tax instruments would not necessarily do away with exemptions, but would have them streamlined in such a way that those exemptions which are retained are indeed addressing a specific problem for the economy in general. There should be a Tax Expenditure Governance Framework to set parameters on when and who needs a tax exemption, how long the exemption stays in place, and the costs and benefits for the country.


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On the administration side, greater efficiency could be achieved through the improved computerization of URA's operations; maintenance of a clean tax register to improve accuracy and confidence in the tax system; and the development of appropriate capacities to support implementation of adopted policies and practices. For instance, government has a well-designed tax-refund system, but its implementation needs improving. Tax payers experience lengthy delays before obtaining a refund, which creates an impression that the system is vulnerable to corruption.

Beyond strengthening of the tax policy and revenue agencies, the World Bank recommends enhancing public awareness, transparency, and civil society engagement, which are crucial to increasing voluntary compliance. Compliance can also be improved through better service delivery, and public investment management that demonstrates value for money, so that citizens and tax-payers have greater confidence in their taxes being well spent.

8. Does domestic revenue mobilization necessarily mean new taxes or higher taxes?

The primary objective is to strengthen the current tax system to be able to substantially increase domestic revenue mobilization and, thereby, support government to take greater leadership in financing Uganda's development, and in delivering essential services needed to end extreme poverty and ensure inclusive development. To ensure equity, however, some entities, income streams or consumption items, which were previously not in the tax base, will need to be included. Furthermore, using sound tax policy analysis, government may consider increasing excise duty rates on items such as tobacco, to ensure that any negative costs caused to the public by their consumption are included in the products price.

9. What can we learn about tax reforms from other countries, which can be benchmarked?

There are many lessons we can draw from other countries. Experience shows that useful measures include setting up a tax Ombudsman[2] to deal with the indiscipline of revenue agency staff, raising awareness of citizen's tax obligations, and cultivating a culture of tax compliance. Fighting corruption and adoption of technology can plug potential leakages in the tax system. ICT can make it easier to disseminate taxpayer services and information online. It is also important to address human and institutional gaps to improve implementation.

2. Uganda has an Inspectorate of Government, to which issues could be referred. However, it has no specialized unit that handles tax related complaints.

10. What is the World Bank's role in advancing the domestic revenue mobilization agenda?

The Bank has the expertise and resources to assist the Government of Ugandan undertake reforms in tax policy and tax administration. The Bank's focus on public expenditure management also gives it a unique insight to help create linkages between taxation, accountability, expenditures, and the broader goals of service-delivery. In terms of current operations, the Bank is already supporting the government in several ways:

- Through the Competitiveness and Enterprise Development Project (CEDP), the Bank supports the roll out of business registration services to help reduce informality. The same project is financing the construction of the Uganda Business Facilitation Centre, which will house three government agencies (URSB, UIA, CMA); a URA one-stop-center that will enable businesses to register and pay taxes more easily; and improvements in land administration and management systems.
- Under the current Great Lakes Trade Facilitation Project, the Bank finances the building/refurbishment of one-stop border posts to improve/hasten tax assessments and clearance of goods in transit.

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