Growth Strategies and Conditions for Pro-poor Growth: Uganda's Experience

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Abstract

Uganda has been challenged to translate recovery-based economic buoyancy into sustainable growth with poverty reduction in pursuit of national and international development targets. As the country weighs various options for stimulating an appropriate response to the economic slowdown of the recent years, it is important that policy considerations be informed by a review of the different growth strategies and episodes that the country has experienced. This paper, therefore, provides an overview of the broad economic strategies that have been implemented in Uganda since 1962 when it attained Independence. By focusing on what transpired during the 1990s into the 2000s, the paper aims to assess the extent to which recent development strategies promoted the participation of poor people in Uganda's growth process. Furthermore, the paper highlights the tradeoffs associated with policies that emphasize growth versus those that emphasize distribution in pursuit of poverty reduction.

1 Introduction

In the initial years after Independence in 1962, Uganda achieved high economic growth, declining poverty and low income inequality by implementing a mixed economic system that featured direct state participation in the real productive sectors of the economy. Social indicators like infant mortality and literacy improved. But during the economic decline that ensued between 1971 and 1986, poverty rose. The reforms that the government began introducing in 1987 helped to improve macroeconomic stability, resulting in improved growth and poverty rates during the 1990s and early 2000s. But after peaking at about 10% in the mid 1990s, annual growth rates slowed down, signaling the end of the kind of growth episode that usually ensues as dividend from restoration of relative political and economic order.

As the country weighs various strategies for stimulating structural transformation for sustainable growth with poverty reduction, it is important that policy considerations be informed by a comprehensive review of the different growth episodes that have been experienced. Specifically, the historical perspective of Uganda's growth is discussed in section two with the objective of identifying the factors that were instrumental in the various growth episodes that have been experienced since Independence. In order to shed light on the extent to which growth has been pro-poor we examine in section three the policies that have affected the participation of poor people in growth, especially during and after the reforms of the 1990s. But given the complex relationships between growth and poverty reduction, we discuss in section four the possible tradeoffs between policy strategies that promote macroeconomic growth irrespective of how broad-based the growth is and pro-poor growth that emphasizes the participation of poor people in the growth process.

2 Historical context of Uganda's growth experience

From levels of economic performance comparable to those of the Southeast Asian countries in the 1960s, Uganda plummeted into the doldrums following political and civil disorder during the 1970s and early 1980s. Whereas the political economic system of Uganda was mixed in the 1960s with a strong role played by state enterprises, from the 1970s to the mid 1980s the state strengthened its control of the economy, leading to sequential contraction of the economy and negative trends in key socioeconomic development indicators.

From 1987 the government of the National Resistance Movement reversed the roles of key economic agents, placing the private sector at the helm of economic growth process while the state served to ensure stable macroeconomic, legal and institutional frameworks. Detailed recovery strategies that benefited from technical and financial support of donors succeeded to reverse the negative economic trends and stimulated high growth with poverty reduction. This section, therefore, motivates and discusses the performance of the Ugandan economy from a historical perspective in order to identify the factors that have driven the country's growth process.

2.1 Key elements of Uganda's political history from 1962 to 2004

Uganda became politically independent from British rule in 1962. In terms of development, the country's development indicators at that time compared favorably with those of South Korea, which has since developed enormously. Uganda opted for a mixed economy but with a heavy hand of Government in the economy. In 1969, Government nationalized big private businesses such as banks. Government's overarching objective in the 1960s was the improvement of welfare of Ugandans through strong co-operative movements and state enterprises. Unfortunately, the co-operative movements became politicized, and eventually collapsed. State enterprises were inefficiently run, incurred losses, and generally became a burden on the national budget.

On the political front, Uganda held multi-party elections in 1962 under the 1962 Uganda Constitution, which provided for co-existence of traditional kingdoms alongside the central government. The king of Buganda Kindgom, Sir Edward Mutesa became the first honorary president of Uganda, with Milton Obote as the elected Prime Minister and Leader of Government Business. The 1962 constitution that provided for co-existence between the central government and the traditional kingdoms worked only for a short time. In 1967 Milton Obote, Uganda's Prime Minister at the time, abrogated the 1962 constitution and replaced it with the 1967 constitution that abolished kingdoms and turned Uganda into a republic. This sowed seeds of political instability, which had adverse consequences on people's livelihoods.

In 1971, Idi Amin took over political power through a military coup and declared his regime the "Second Republic of Uganda". Kingdoms and democracy were thus silenced. Idi Amin ruled by decree from 1971 to 1979 when a combined force of Tanzanian and Ugandan forces pushed him out of power by force of arms. After the overthrow of Idi Amin, Uganda underwent quick sessions of leadership changes. Yusuf Lule's short reign of 68 days followed that of Idi Amin. Godfrey Lukongwa Binaisa who came to power after Lule ruled for only one year before he was replaced by Paulo Muwanga who ruled Uganda as Chairperson of a ruling military commission. Within a period of about one year, Paulo Muwanga handed over power to Milton Obote after elections in 1980 under the 1967 constitution.

In 1981, Yoweri Museveni who had been vice Chairperson of the military commission took up arms to fight and overthrow Milton Obote's government on account of rigging the 1980 democratic elections. Despite the armed opposition, Milton Obote persisted in power from 1980 to the time Tito Okello Lutwa overthrew him in a military coup in 1985. By that time, there were many fighting groups in Uganda and it became a daunting task for Tito Lutwa to establish peace throughout the country. The government of the day approached some of the fighting groups to pursue a negotiated settlement. But the complexity of the political situation at that time rendered such peace initiatives fruitless. In 1986 Yoweri Museveni's forces overran Kampala, thus bringing Museveni into power. Overall, the war situation adversely affected peoples' livelihoods, especially in the Central region, which was the epicenter of the war.

Since 1986, various armed groups have fought President Yoweri Museveni's government with the aim of overthrowing it. The Lord's Resistance Army (LRA) and the Allied Democratic Forces (ADF) are the major groups that have fought Museveni's government. In the new war-ravaged areas, especially Northern Uganda, poverty increased during the last two decades, notwithstanding general decline in poverty at the national level during the period. However, since 1986, government has implemented various measures to ensure democratic and constitutional rule. The most notable ones include the promulgation of the 1995 Constitution, and the enactment of the 1997 Local Government Act. Presidential and parliamentary elections were held in 1986 and 2001. But the 1995 Uganda Constitution limits the role of political parties, a matter that has become of great concern to many Ugandans and sections of the international community. This matter and others are being addressed through a constitution review process in the parliament of Uganda.

2.2 Key features of Uganda's political economy since 1962

For about two decades from Uganda's independence in 1962, controls of various forms characterized Uganda's economy. For example, the foreign exchange rate was fixed, as a result of which the shilling became overvalued. Marketing of agricultural products was through monopoly marketing boards; there was the Lint Marketing Board for cotton; the Coffee Marketing Board for coffee; and the Produce Marketing Board for agricultural food products like beans and maize. Government fixed the prices for agricultural commodities and passed on to the farmer a fraction of the international prices of the tradable commodities. During the 1960s the Uganda government of the day used the co-operative movement to mobilize farmers to produce mainly the export commodities. Coupled with an efficient farmer extension service system, agricultural production increased tremendously and Gross Domestic Product (GDP) as a whole grew at impressive rates of 4-6% per year. Paucity of data notwithstanding, inequality was hardly an issue during the 1960s; the egalitarian policies of the day ensured equitable agriculture-led economic growth.

Uganda's population at the time of independence was about 7 million people. The population increased from 4.9 million in 1949 to 6.5 million in 1959. It then increased to 9.5 million in 1969 before increasing further to 12.6 million in 1980. In 1991 Uganda's population stood at 16.7 million and was about 24.5 million in 2002. According to the Uganda Bureau of Statistics (UBoS, 2003) more than 50% of the population is below 15 years of age. With this population growth trend, Uganda requires about 4% annual rate of growth of its GDP per capita in order to achieve its poverty reduction target of less than 10% headcount by the year 2017.

Economic decline characterized the Ugandan economy during the1970s starting from the time Idi Amin took over power in 1971. The phenomenal growth and welfare improvements the country registered in the 1960s was short-lived because of the political developments and economic mismanagement during the 1970s. The 1971 military coup that brought Idi Amin to power marked the beginning of Uganda's economic woes. Uganda suffered economic and political sanctions by the international community following the expulsion from the country Ugandans of Asian origin, whom Idi Amin had accused of economic exploitation.

Due to the political, civil and economic disorder that ensued from the early 1970s to the mid 1980s, the economy contracted significantly as a direct result of destruction, dissaving, physical and human capital flight, and reduced productivity through disruption and diversion of expenditure (Collier and Reinikka, 2001). GDP declined by 40% from 1971 to 1986, which Collier and Ritva estimate to have translated into a 1% annual decline in the economy. As the economy shrank, the social welfare indicators worsened. Uganda's economic performance during the early 1980s was not better mainly because of political and social unrest and continued mismanagement of the economy. In 1984, the economy shrank by 4%; in 1985 it grew by only 0.2% and in 1986 by only 1.1%. Annual inflation rate rose to three digits mainly because of Government financing of the fiscal deficit through borrowing from the domestic market.

As a consequence of the political instability and shrinkage of the economy, poverty increased during the early 1980s. In an effort to revamp the economy government approached the IMF and World Bank for assistance. However, no sooner had the government started implementing stabilization policies than it abandoned them in 1984, partly due to the political demand of fighting the then guerilla forces of Yoweri Museveni. Consequently, poverty rose during the first half of the 1980s.

2.3 Economic recovery strategy after 1986

Uganda embarked on implementation of economic reforms in 1987 with a view to correcting macroeconomic imbalances and removing inefficiencies in production and distribution of goods and services so as to register high rates of economic growth. Unlike in previous years, government recognized the private sector as a partner in development. The private sector was to lead the process of economic growth while the state ensured macroeconomic stability and legal and institutional frameworks that are supportive of private sector led economic growth. In government's view, foreign direct investment (FDI) was to play a lead role in private sector development.

Following the restoration of relative political and economic order in most parts of the country in the second half of the 1980s, coupled with strong leadership commitment to reform, the country attracted substantial donor support for an Economic Recovery Program (ERP) that was launched in May 1987, an initiative that was immediately followed by a sequence of Structural Adjustment Programs (SAP). The ERP that was supported by the Economic Recovery Credits (ERC) and Structural Adjustment Credits (SAC) from the International Development Association and the Enhanced Structural Adjustment Facility (ESAF) from the International Monetary Fund, plus other multi-lateral and bilateral assistance were primarily aimed at realizing economic rehabilitation, growth, domestic financial stability, and low inflation rates. An important aspect of the reform strategy was trade liberalization through extensive reduction of nontariff barriers, competitive tendering for government purchasing and a switch from export taxation to import taxation. Significant gains were realized from trade liberalization, for example, the 1991/92 abolition of coffee export tax together with overall coffee marketing liberalization increased competition among exporters, resulting in producer prices received by coffee growers as a share of border prices increasing sharply from 30% to more than 80% (Collier and Reinikka, 2001).

Concerns about the likely poverty impact of the reforms prompted the preparation and implementation of the Program for the Alleviation of Poverty and Social Costs of Adjustment (PAPSCA), whose focus on poverty was later seen to be narrow. In 1997, Uganda prepared the Poverty Eradication Action Plan (PEAP), which turned out to be the country's holistic development framework covering economic management, governance and security, increasing the incomes of the poor, and improving delivery of social services. Another dimension of improving delivery of social services was decentralization, which was implemented with a view to improving efficiency and quality in the delivery of social services, among other things. The enactment of the Local Government Act in 1997 marked the beginning of devolution of political power to local governments, and with it the power to manage the development process including public finance at the local government level. However, the extent to which decentralization led to improvements in the quality of social services and efficiency in public resource management remains a debatable issue.

2.4 Broad growth strategies since 1986

As noted already, maintenance of macroeconomic stability has been Uganda's immediate objective, especially from 1993. Working closely with the fiscal authorities, the central bank (Bank of Uganda) ensured that money expanded at a rate commensurate with the demands of the real sector. Excess liquidity would be mopped up by issuance of treasury bills and/or sale of foreign exchange. Treasury bills were issued for liquidity management purposes only and not for short-term financing of the national budget. The macroeconomic management strategy led to significant growth rates averaging 6.5% per annum for the 1990s.

To translate the macroeconomic achievements to micro-level benefits and to operationalize the country's holistic framework for development (the PEAP), detailed plans of action and goals for particular sectors are developed in the respective sector development plans, such as the Education Sector Investment Plan, Health Sector Strategic Plan, Plan for Modernization of Agriculture, Social Development Sector Strategic Plan, and Road Sector Development Plan. The implementation of the various sector-wide plans depends on the resources (spending ceilings) provided within the Medium Term Expenditure Framework (MTEF), which is a three-year rolling spending plan that links priority public spending areas to medium-term development goals.[1] Because of budgetary discipline, which is central to MTEF operationalization, any shortfalls in resources are met with matching within-year budget cuts except for activities under the Poverty Action Fund (PAF) (a common pool to which debt-relief funds are channeled for use on directly poverty-reducing programs).[2] But making within-year adjustments or cuts in the releases of funds disrupts original funding plans because it increases volatility and weakens the budget as the instrument for allocating public resources (Henstridge and Kasekende, 2001). Fortunately there have been minimal severe consequences of such fiscal disciplinary measures, partly because stable macroeconomic conditions have undoubtedly made it easier to forecast revenues and expenditures (World Bank, 2003, pp. 62).

[1] Many of Uganda's development goals are to be achieved ultimately in the private sector. Accordingly, the government emphasizes the promotion of the private sector as evident in the 1999/2000 launch of a five year Medium-Term Competitiveness Strategy (MTCS) to tackle major constraints to private sector development.

[2] After committing to creating and protecting the Poverty Action Fund, Uganda became the first country to benefit from the September 1996 decision of the World Bank and the IMF to grant debt relief to heavily indebted poor countries (HIPC) (Mijumbi, 2001).

In pursuit of private-sector-led and investment-driven growth, government reversed the investment incentive system that was initially biased in favor of domestic firms. The investment code of 1991 relaxed numerous constraints and introduced attractive incentives for foreign direct investment. Successful implementation of privatization of non-performing state enterprises further induced efficiency and boosted the growth of the private sector in industrial, commercial, agricultural, and hotel sectors. By the end of 1999, the government had completed 93 divestitures of enterprises, privatizing 62 firms and liquidating the remainder (Collier and Reinikka, 2001). The Uganda Investment Authority (UIA) was created to focus on promoting favorable climate for the establishment of private sector businesses, with strong emphasis on FDI and the Medium Term Competitiveness Strategy was formulated to enhance overall growth of the private sector. Thus, the role of government and that of the private sector in the economic growth process were well defined.

2.5 Sectoral contributions to growth since 1986

Starting from a low base, Uganda's economy grew at an impressive rate that averaged about 6.3% per annum for the fifteen fiscal years starting from 1987/88. The high rates of economic growth were attained on account of the good economic policies that led to increases in foreign direct investment, inward repatriation of earning by Ugandans living abroad, and high growth of the real sector. The fastest growing sectors in descending order were mining and quarrying, manufacturing, hotels and restaurants, and construction, whose average growth during the fifteen years was 24.6%, 11.8%, 10.7%, and 10.0% respectively. However, as a proportion of GDP in 2002/03 mining and quarrying was only 0.8%, manufacturing 9.9% and hotels and restaurants 1.9%.

Community services, which in 2002/03 accounted for 19.1% of GDP (Table 2), grew at an average rate of 6.8% during the fifteen years from 1987. This was slightly higher than the average GDP growth rate of 6.3%. Community services include education, health and general government. The growth of community services is partly associated with increased public sector spending on these sectors, supported with donor funding. Throughout the 1990s and in the current decade, donors have given substantial support to education and health. Thus, public sector spending on community services, which donor support made possible, explains a significant part of Uganda's high economic growth between 1987 and 2003.

The transport and communication sector recorded high growth with air and support services driving the growth. The road sub-sector received substantial donor support during the 1990s into the 2000s but the telecommunications sub-sector grew during this period without donor support. The railway was the worst performing transport sub-sector, shrinking by 3.5% in 92/93, 5.9% in 95/96, 22.6% in 96/97, and 12.6% in 97/98 mainly due to mismanagement.

Like the sectoral pattern of the economy, the structure of public revenue also remained largely unchanged. For example, government revenue grew from 6.6% of GDP in 1985/86 to 11.6% in 1998/99 but has hardly risen beyond the 12.1% registered in 2001/02.

In a nutshell, the good policies of the 1990s helped to reverse the GDP decline of the 1970s and early 1980s. Although agriculture, the sector where the majority of the population is engaged, grew slower than the overall GDP growth, fast growth in the other sectors sufficiently compensated for this slower growth to keep the economy growing at higher growth rates than most Sub-Saharan African countries. For example, growth of community services, whose share in GDP in 2002/03 was 19.1%, seems to have been a key driver of Uganda's growth between 1987 and 2003. But the sustainability of good performance

Table 1: GDP (1997/98 prices) – Percentage growth rates

Industry Group	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Monetary Agriculture	5.4	1.3	-2.9	-0.1	1.8	5.4	6.6	7.5	5.8	2.5	10.1	4.7	7.9	8.4	3.9	2.2	6.6	5.2	4.5	5.7	3.9	1.6
Cash Crops	1.2	2.5	2.4	-3.7	-1.0	0.4	5.8	8.4	3.8	7.3	0.3	10.5	8.0	22.6	13.9	-2.8	9.3	7.0	-4.9	7.4	4.6	0.3
Food Crops	10.1	-0.7	-7.1	4.3	3.4	7.0	8.7	9.0	6.2	0.6	17.3	5.3	11.7	4.4	-0.2	3.0	7.5	5.9	8.2	5.7	3.7	1.7
Livestock	0.7	-0.6	-3.0	-4.2	-0.2	6.0	5.6	3.5	3.7	2.1	3.5	2.8	-4.9	12.2	5.5	4.0	4.1	3.3	3.8	4.4	3.9	1.1
Fishing	1.3	11.8	7.7	-2.7	2.3	3.3	1.0	7.0	9.3	3.9	4.1	-3.5	8.8	2.5	4.5	5.0	0.9	-0.1	4.0	3.5	3.2	3.4
Non-Monetary Agriculture	6.0	0.3	-3.6	4.8	2.3	5.3	5.8	3.8	0.7	-3.9	8.8	-0.9	5.0	0.1	-1.9	1.2	4.9	6.1	4.6	1.7	0.1	1.6
Mining & Quarrying	17.1	-2.2	-16.8	-12.2	-9.7	-11.5	4.4	73.7	106.1	10.4	10.4	3.7	9.1	35.7	50.2	27.7	14.5	6.3	10.1	11.1	2.7	5.4
Manufacturing	13.2	-3.7	-6.3	-4.0	6.0	19.6	12.3	-0.9	11.0	21.7	1.9	15.4	11.6	29.5	14.2	4.4	14.1	3.6	8.9	5.3	4.0	4.5
Electricity & Water	-1.3	0.4	7.2	5.7	4.4	6.5	4.4	2.2	6.4	10.0	5.7	7.3	11.4	10.5	10.1	7.0	6.0	8.7	8.2	5.4	4.7	6.6
Construction	3.1	-5.1	-6.1	-8.0	36.3	27.0	-0.5	5.1	7.3	1.1	11.2	13.5	28.1	14.4	7.7	8.0	10.9	7.3	1.8	12.5	12.2	13.8
Trade	9.2	0.8	-3.8	-2.7	2.6	12.0	7.2	6.2	7.1	5.8	6.0	8.1	22.0	10.9	2.3	6.3	10.5	1.8	6.0	5.9	4.1	3.9
Hotels & Restaurants	12.2	-2.4	-12.8	-0.1	10.8	12.7	9.5	12.2	14.6	14.1	14.9	19.5	18.9	9.4	9.1	4.4	7.3	5.3	7.1	18.1	7.5	19.1
Transport/Communication	6.9	1.0	-2.6	0.0	4.9	7.2	5.7	6.4	7.4	5.4	7.3	10.0	13.4	10.6	10.8	9.6	7.0	7.3	9.6	12.4	14.9	19.9
Community Services	5.1	3.0	0.6	1.2	3.2	4.1	6.6	7.1	8.4	8.8	7.4	6.0	7.0	6.0	6.3	5.8	4.5	8.6	3.5	6.4	5.0	5.5
Total GDP	6.1	0.7	-2.6	1.0	3.8	7.3	6.2	5.5	5.5	3.7	8.0	5.4	10.0	8.3	4.8	4.4	7.4	5.8	5.0	6.4	4.7	5.9

Source: Ministry of Finance, Planning and Economic Development (MFPED)

Table 2: Major sectoral contributions to GDP

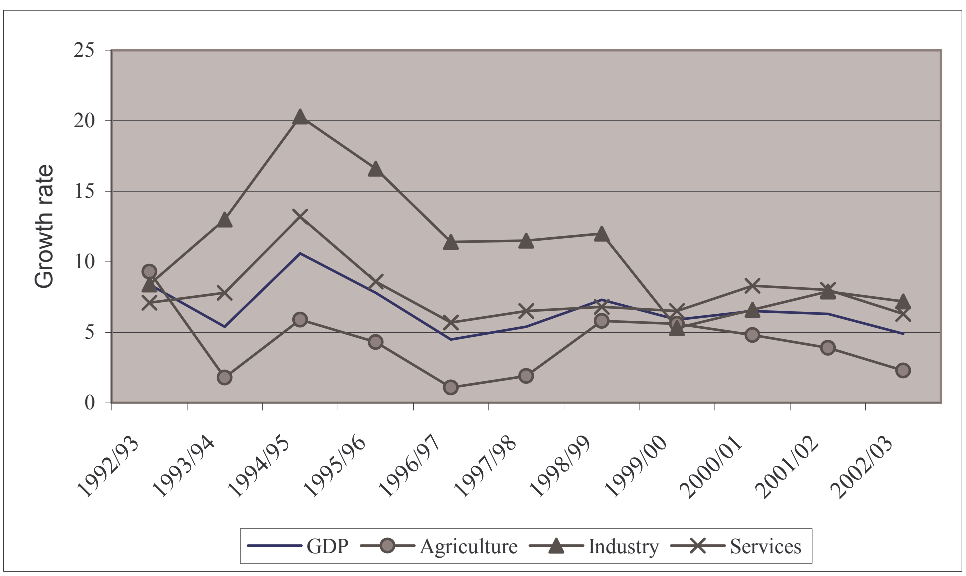
Industry group	97/98	98/99	99/00	00/01	01/02	02/03
Monetary Agriculture	23.4	23.2	23.1	22.8	22.7	22.5
Non-monetary Agriculture	18.6	18.2	18.2	18.1	17.7	16.9
Manufacturing	9.1	9.7	9.5	9.8	9.8	9.9
Construction	6.3	6.5	6.6	6.3	6.4	6.7
Wholesale & Retail Trade	10.7	11.0	10.6	10.7	10.8	11.0
Transport & Communications	4.7	4.7	4.8	5.0	5.2	5.4
Community Services	19.2	18.6	19.1	19.1	19.1	19.1
Owner-occupied dwellings	3.4	3.4	3.5	3.6	3.6	3.7

Source: MFPED

proved to be illusive, with real growth peaking at about 10% in 1994/95, after which it declined to 4.4% in 1997/98 before rising to 7.4% in 1998/99 (Table 1 and Figure 1). These periods of growth were characterized by some degree of structural shifts as well, with the share of agriculture in GDP dropping from 56.1 to 41.5 between 1985/86 and 1998/99 and then declining only slightly to 40.5% in 2001/02. Relative to GDP, investment increased from 8.4% in 1985/86 to 19% in 1998/99 after which it only slightly rose to 20.7% in 2001/02. Over the same period exports share in GDP jumped from 5.8% to 11.8% before tapering off to 11.9 after 1999/2000. But the share of import rose continuously, from 8.6% in 1985/86 to 24.2% in 1998/99 and up to 27.7% in 2001/02.

Several factors can explain the economic slowdown that started in 1995. On the domestic front, unfavorable weather conditions (El nino of 1997; prolonged drought in 2001/02) led to poor performance of the agricultural sector. Furthermore, poor access to productive assets, especially credit and land, constrained performance of firms and individuals engaged in agriculture. Despite increases in farm gate prices of agricultural prices because of liberalization, the production incentive structure favored non-agricultural activities. This partly explains the low growth of the agricultural sector during the past decade. Since 1999/00 real growth rates in GDP remained below the 7% rate set in the PEAP to meet poverty eradication goals by 2017. It is also observed that the ratio of the monetary to non-monetary agriculture has remained unchanged overtime. This suggests that the change to market based agriculture remains low and this has implications for the Government's PMA program.

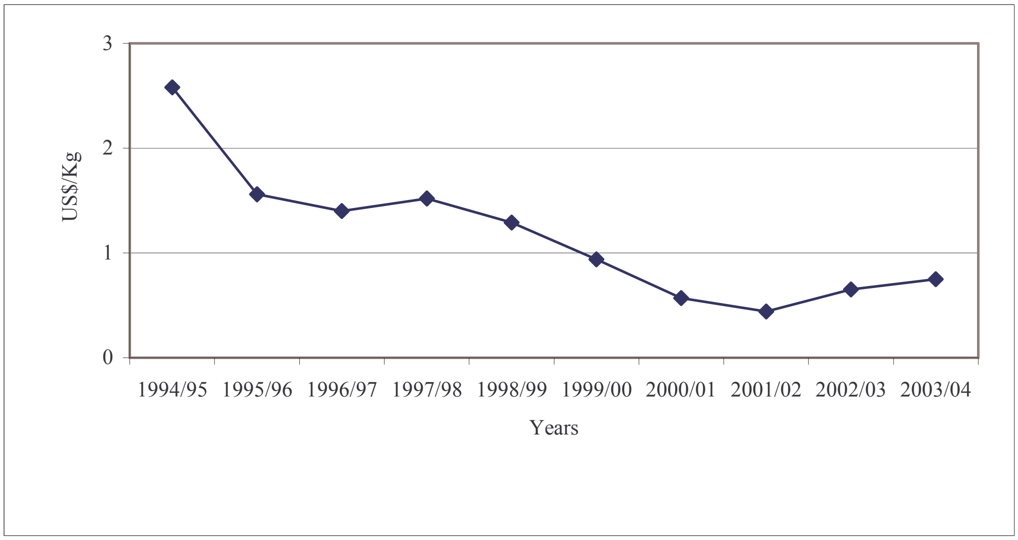
Figure 1: **Growth in GDP, Agriculture, Industry and Services**



Source: MoFPED

On the external front, declines in the international price of coffee (Figure 2) and rising oil prices have exacerbated the growth slowdown. Because of unfavorable coffee prices on the international market, proceeds from coffee exports declined almost every subsequent year from the mid 1990s.

Figure 2: International Prices of Coffee



Source: Uganda Coffee Development Authority

In the early 1990s and especially at the time of the coffee boom in 1994/95, coffee played a key role in the country's economic growth process. As the international price of coffee declined, the rate of economic growth began declining too, despite the same or even higher quantities of coffee produced. Clearly, coffee played a significant role in Uganda's economic growth performance. Besides coffee, non-traditional exports played a significant role in Uganda's economic growth performance especially from the mid 1990s. The value of non-traditional exports improved significantly. From almost nothing in the early 1990s, in 2003, fish fetched about US$40 million, flowers about US$20 million, cobalt about US$10 million, and cereals about US$10 million. But annual total export receipts are likely to remain below US$700 million despite improved performance of non-traditional exports.

2.6 Welfare impacts and emerging challenges of the strategies

Since its inception the PEAP has been revised twice, in 2000 and in 2004 with a view to addressing emerging development challenges. Government put in place mechanisms for monitoring household and firm level effects of macroeconomic policies in general and the PEAP in particular.[3] Overall, the recovery and growth strategies have realized impressive poverty reduction results, with the headcount index of total income poverty declining from 56% in 1992 (corresponding to 9.2 million persons, in absolute numbers) to 34% (corresponding to 7.2 million persons) in 2000 after which it rose to 38% (corresponding to 8.9 million persons) in 2003.[4] However, poverty in Uganda remains a rural phenomenon and more pronounced among crop farmers.

[3] It is on the basis of analytical results from the various household and firm surveys and from other research and policy analyses that the revision of the PEAP is conducted. The key objective of the revision is usually to rationalize any prioritization of the challenges facing the PEAP. Promotion of private sector investment for job creation and poverty reduction is basically the overriding strategic focus.

[4] Panel data evidence shows that between 1992 and 2000 a significant proportion of Ugandans (20%) experienced chronic poverty, 30% moved out of poverty, and about 10% fell into poverty (Lawson, *et al.* 2003).

Uganda's focus on poverty reduction notwithstanding, the country still faces several poverty reduction challenges. On the public sector side, there are challenges to raising additional resources to finance the country's development process on the one hand, and to remove inefficiency in the use of financial resources on the other. There is concern about the size of the fiscal deficit and its implication for other macroeconomic aggregates particularly inflation and interest rates. It is broadly agreed that the fiscal deficit should be reduced to give the private sector space and a favorable environment to develop. However, reduced public sector spending could adversely affect the quantity and quality of social services delivered by the public sector. Regarding inefficiency in the use of public financial resources, government has taken several measures to reduce corruption, such as putting in place an institutional framework for curbing the vice. However, corruption and inefficiency in the use of public resources at all levels of government remains enormous.

The private sector too plays a significant role in poverty reduction. However, private sector participation in the development process, particularly by the weaker segments of society faces several constraints. Poor access to productive assets, high interest rates, low level of technology, costly utilities, and inadequate public sector support are among the key constraints facing private sector development in Uganda. In short, the investment climate is still not quite supportive of local investment.

Small and micro enterprises (SMEs) face several production and marketing constraints that government has not adequately addressed. While domestic investors face an unfavorable environment to doing business, foreign investors have not come in the numbers that government initially anticipated. Furthermore, the foreign investors that came disproportionately concentrated in the serviced sector.

3 Policies that have affected the participation of poor people in growth

For the poor to effectively contribute to growth, the productivity of their assets must increase (for example, through improvements of the status of their health and education). Given the importance of initial conditions, the poor may have to be facilitated to enable them participate both in the factor and product markets. Policies that improve the quality and value of the assets of the poor must be complemented by policies that ensure efficient utilization of the assets.

This section, therefore, discusses the policies that have affected the participation of poor people in growth and assesses the effectiveness of such policies in promoting pro-poor growth. The key sets of policies discussed in the section include: (a) macroeconomic policies that affect general price levels and asset values; (b) labor market and rural development policies that affect wages/remittances and farmers' input and output prices; (c) pro-poor spending that raise growth as well as productivity of assets; and (d) policies that are designed to affect the pattern of growth.

3.1 Macroeconomic policies

The major macroeconomic policies that have affected the participation of poor Ugandans in growth include price stabilization and trade liberalization. Price stabilization may be looked at in terms of policies that liberalize consumer prices, foreign exchange rates and interest rates. Since 1992 Uganda has controlled inflation in single digits and kept it below 5% per annum for most years. The shilling depreciated significantly from Ug.Shs 966 per dollar in January 1992 to Ug.Shs 1,985 per dollar in September 2003. The depreciation of the shilling has raised concerns of possible negative effects on revenue collection and external sector competitiveness. However, real lending interest rates, which were negative, turned positive from 1994, rising to over 25% per annum.

Liberalization and privatization are the major trade polices Uganda implemented during the 1990s. These polices were intended to maximize economic growth through efficiency gains in resource allocation, production and distribution of goods and services. The Uganda Investment Authority (UIA) was established to assist business startup, especially by foreign investors. The thinking was that foreign investment would create jobs and thereby increase the participation of Ugandans in the economic growth process. The stable macroeconomic environment was perceived as a necessary condition for both foreign direct investment and domestic investment, which would lead to job creation and participation of the poor in the growth process.

While Uganda should be applauded for macroeconomic stability, there are concerns that trade polices, especially in the 1990s, favored foreign investment at the expense of domestic investment. Although foreign direct investment increased, it did not increase to the anticipated level, creating much less than anticipated levels of employment. Thus, the macroeconomic policies that were implemented did not sufficiently induce participation by the poor people in the economic growth process. Efficiency in resource allocation, production and distribution was the priority. Accordingly, the policies encouraged use of capital and new technologies at the expense of job creation.

Analysis by Gauthier (2001), based on survey data for 1995-97 showed that all levels of productivity greatly favored exporting firms and those with a component of foreign ownership. Efficiency levels for exporters were 0.23 compared to 0.18 for non-exporters. Even when measures of technical efficiency were used, Gauthier reported that on a cumulative basis exporters were more efficient, with levels of 7.3% compared to –5.3% for non-exporters. Recent evidence by Kappel et al (2004) sheds some light on the effect of trade liberalization and the high degree of openness on competition, efficiency, and growth of firms. Using the business register produced by UBOS (2003), the study reports that 60% of the medium to small enterprises (MSEs) grew substantially because of operating in a competitive market environment. This is an indication that competition might have increased efficiency and growth for a number of firms. However, this conclusion should be taken with caution because UBOS survey only dealt with existing firms and did not capture firms that had closed.

There is evidence[5], therefore, to suggest that the macroeconomic environment has been more favorable to foreign direct investment compared to domestic investment. Domestic investors face other production constraints, especially the cost of credit, which is of lesser concern to foreign investors. In recent years, the investment incentive structure has become

[5] The apparent decline in the work force could be attributed to the Universal Primary Education program that has enrolled a significant fraction of the originally non-school going family child labor.

more favorable to categories of investment that do not offer sufficient opportunities for participation in the growth process by a wider section of Ugandans. The categories of investment in this regard include investment in financial instruments (especially treasury bills) and/or investment in non-tradable items (such as transport services). These are more attractive to investors because of the returns and fewer risks compared to investment in tradable items (such as agriculture and manufacturing of export commodities). Yet, investment in tradable commodities offers higher chances of participation by a wider section of society.

3.2 Labor market

Workforce participation, which we crudely define as workforce[6] divided by the total population aged 10 years and above, declined from 64% in 1992 and stabilized at about 59% through 1999 to 2003. This evidence from the series of the Uganda National Household Surveys shows that the decline in poverty in the early 1990s was accompanied by a fall in workforce participation and a rise in per capita consumption expenditure.

Micro-level evidence suggests that the share of agriculture in rural employment is on the decline, with workers shifting to non-agricultural sectors. This evidence is consistent with the overall changes in the composition of GDP. However, the rate of diversification is much slower for female compared to male workers. Nationally, employment grew by 2.7% during the period 1992 to 1999 and by 2.8% between 1999 and 2002. The corresponding figures for rural areas were 2.5 and 2.3 and for urban areas they were 4.6 and 5.7 over the same period. These figures suggest that the rate of growth in employment has been positive overtime, but well below GDP growth rate. During the period 1999 through 2003, employment trends in the rural areas were consistent with the GDP growth rates.

At sector level, smaller sectors have experienced higher growth rates and increasing share of the labor force over time. In the initial period (1992/93) crop agriculture, manufacturing, trade and government services contributed significant shares of employment. Apart from mining and public utilities, other non-agricultural sectors experienced positive employment growth rates during the 1990s. The sectors that experienced high employment growth rates include manufacturing, trade, hotels and transport and communication. Although crop agriculture remains a key sector in terms of employment, it is one of the sectors with the weakest economic growth. While the participation of the poor in sectors that experienced high employment growth increased with the exception of government services, their shares are relatively lower than that of the non-poor individuals. In other words, the rural poor continue to rely on agriculture, which, as an economic sector, is growing slowly as already pointed out. This has negative implications for the livelihood of the rural population.

In terms of gender, the share of female workers in the workforce increased from 49.8 in 1992/93 but stagnated at 52.2% between 1999 through 2003. Female participation in the workforce remains concentrated in agriculture although the trend has been declining overtime. However, females' share is declining at a much slower pace than that of males, and shifting mainly to non-tradable sectors.

[6] Individuals in the workforce were derived based on their usual main activity status, which UBoS defines as an activity where an individual spends more time.

As already discussed diversification is taking place when agricultural growth is on a decline and earnings lagging behind those from the non-agricultural sectors. Restricting the analysis[7] to paid employment it is found that there was a significant fall in the growth rates of earnings during 1992-99 compared to 1999-02. Real earnings increased in all sectors during the period 1992 through 1999, however, some sectors recorded negative growth, either at the mean or median over the period 1999 through 2002. Most notable is the high growth in the manufacturing and trade sectors during 1999-02, which was followed by a decline in the real wages over the same period. This suggests that the influx of people into the manufacturing and trade sectors suppressed returns in the sectors. Related studies such as Obwona and Ssewanyana (2004) reported rural wages for non-agricultural activities to be significantly higher than those for agricultural activities. In addition, there was a gender wage gap with female being paid less than men in both activities. Evidence from the National Household Surveys shows that over time, the earnings gap between government and private employees has widened (World Bank, 2005). Other surveys conducted by UBoS report similar trends in earnings/wages. The recent survey of the manufacturing industries indicated that, though the number of employees has increased over the years, the wage bill has not increased relatively at the same rate. Even with inflation rates of 5% per annum, trends in nominal wages imply that real wages have been on the decline and must have had an adverse effect on remittances.

In terms of employment status, our analysis of the National Household Survey data finds a decline in self-employment in agriculture and an increase in self-employment in non-agricultural activities in rural areas. Self-employment in non-agricultural sectors doubled between 1999 and 2003. While the share of urban population in government employment followed a declining trend, that of the rural population followed a U shape, although the share of government employment remains less than the level realized in 1992/93. On the other hand, the share of employment in private sector firms recorded an increasing trend but remains below 10%. Both private and government employment seem to be moving from urban to rural areas. The recruitment of teachers partly explains the increase in government employment. Despite the observed move out of agricultural self-employment, the rural population remains reliant on agricultural.

Education is among the initial conditions required to increase one's opportunities in the labor market. Here we discuss how education is related to labor market participation. There is demand for more educated workers across sectors including crop agriculture. Noticeably, the move from crop agriculture to non-agriculture requires a more educated workforce. In terms of returns to labor, by influencing earnings, education is a key factor underlying the increasing income inequality in Uganda (Ssewanyana *et al*. 2004). Thus, the potential for rural workers to get into better paying employment is extremely limited given their low levels of education. This, in turn, limits their participation in high employment growth sectors. More so, the argument that openness of the economy would promote demand for unskilled labor is likely to have been counteracted by the poor performance of the export sector. Besides, it argued that successful export production requires a combination of basic and other post-school forms of education (Berry *et al.*, 1997; Owens and Wood, 1997), which is absent among the majority of unskilled rural poor.

[7] . Earnings in 2002/03 were collected for only those individuals in paid employment.

Industrial growth has largely been in the manufacturing sector among the large companies, which, apart from a few like tobacco and sugar, have little or no linkages with small scale producers in the rural sector. Even then, UNDP (1997) indicated that liberalization made it easier for firms to adopt capital-intensive technologies, increased productivity and returns to owners of capital assets, and increased demand for skilled labor thereby worsening income distribution. This is in line with the observation that the distribution between incomes from labor and capital in industry shifted in the direction of capital, which led to changes in consumption patterns and lifestyles and worsened inequity (Pieper, 1997; Amsden and van der Hoeven, 1996).

So far the analysis suggests that structural transformation has been sluggish both at macro and micro levels. Growth in the volume of employment did not translate into better earnings and in turn better welfare. The rural population remains locked up in crop agriculture, which has grown the least in the last few years. Even those in paid employment in agriculture receive wages well below their counterparts in other sectors. Little progress has been made in increasing the value chain of agricultural production via agro-processing. This poses a challenge of creating jobs in non-agricultural sectors especially in those with higher potential and at the same time investing in improving the skills of the rural population. It thus calls for interventions that ensure not only adequate growth in the volume of employment but also sufficient growth in better paying employment. The structural transformation process has been partly slowed down by lack of access to productive assets as discussed in the next section.

3.3 Access to productive assets

In broad terms, access to infrastructure that allows the poor to respond to opportunities in the production of tradable commodities has improved over time. Retrospective survey data on community characteristics indicate that households were closer to rural infrastructure such as roads, electricity, schools and health facilities in 2002/03 than in 1992. However, issues of quality have been raised especially for schools and health facilities. As discussed in section 2, such improvements partly contributed to poverty reduction among the panel households in the 1990s. However, further improvements in these services since 2000 have not translated into poverty reduction. The existing inequality in the distribution of infrastructure may also influence participation in growth. Regionally, the central region has the best infrastructure to benefit from a liberalized marketing system (Obwona and Ssewanyana, 2004).

There is empirical evidence that crop yields at the farm level are far below those attained at research stations (MoFPED, 1996; Republic of Uganda, 2003). Farming households covered in 1999/00 reported their crop yields to have declined or stagnated compared to the situation in 1992 (Obwona and Ssewanyana*,* 2004). The increases observed in crop production are mainly a result of increases in cultivated land. Although with the liberalization of the input markets one would have expected such increases to come from higher application of agricultural inputs. Some studies such as Obwona and Ssewanyana (2004) and Pender *et al.* (2004) find agricultural productivity to be influenced by other factors beyond physical infrastructure. Despite the benefits that come with application of productivity enhancing technologies, the adoption remains limited due to supply and demand constraints. The markets for these inputs are fragmented, characterized by seasonality in demand, small rural markets, low returns in relation to other investments and low household incomes. These factors combine to make agricultural input marketing a financially risky investment for the private sector.

The trends in the use of these technologies have been disappointing. For instance, there was a decline in the use of improved seeds between 1992 and 1999; the application of fertilizers remain very low and where fertilizers are said to have yielded positive economic returns, such returns have not translated into widespread adoption (Nkonya *et al*. 2003). This could be associated with limited financial and human capacity of households to respectively purchase and adopt such technologies.

While there is empirical evidence indicating that past efforts by government to provide extension services were effective in increasing production of field crop and livestock (MoFPED, 1996), according to the 1999/00 National Household Survey, access to extension services have been skewed towards the richer households.

While the microfinance sector has been able to grow fast and cater for the financial needs of the micro enterprises that the larger financial institutions have traditionally failed to address, it remains characterized by smaller loans, with very short repayment cycles which are definitely not suitable for agricultural production, and biased towards urban areas. Where such institutions exist in the rural areas they favor the richer farming households and are biased towards non-agricultural activities (Obwona and Ssewanyana, 2004). A survey conducted by MoFPED found these institutions to play a significant role in supporting small enterprises and enhancing the economic potential of women. Past efforts by the Government to provide formal financial services to the rural population have been abused. To date, informal credit remains a common source of credit in the rural areas. In the absence of rural credit, the rural population has to rely on personal savings to finance long-term investments in agriculture, but the levels of savings are very low. All this suggests that improved access to social services is necessary but not sufficient to ensure increased productivity of the rural population.

There is no doubt that agricultural market information helps in minimizing farmers' risks when it is incorporated in the planning process of crop and animal production. Only 30% of the farming households in Uganda receive market information. While the private sector is active in this area, the government plays a key role. Besides market information, dissemination of weather information is still weak. Timely dissemination of such information is growing in importance given the increasing unpredictable changes in weather conditions.

The land reform introduced by the Land Act of 1998 is yet to yield the expected results. Because most of the institutions provided for in the Land Act have not be put in place, conflicts and limited use of land as collateral for formal credit have undermined the key objectives of the land law to strengthen land rights, minimize conflicts and increase land access.

The quality of environment and natural resources on which people depend is declining, which in turn results into reduced incomes. Poor people identify environmental degradation to be among the factors that continue to contribute to the poor performance of the agricultural sector (Republic of Uganda, 2003). Related studies such as Nkonya *et al.* (2004)

provide empirical evidence on the extent of land degradation in the country and warn that agricultural development will be affected if nothing is done in the near future. Environmental degradation is also reported around the fishing points caused by fish processing companies, leading to a reduction in the fish catch. By extension, there are laws that are anti-poor because they influenced the participation of the poor in the fishing industry under the guise of environmental protection. Unable to increase the productivity from their limited resources, the rural people are often forced to adopt environmentally unfriendly practices that tend to aggravate poverty, for example, the utilization of wetlands and gazetted forest areas.

It remains debatable whether liberalization and macroeconomic stabilization have so far led to lower transaction costs in agriculture. For a landlocked country like Uganda, the international transaction costs remain too high to attract large scale participation of foreign direct investors in agriculture. The performance of rail transportation, a key to reducing such costs, has been extremely poor. By extension, the domestic transaction costs remain high in the rural areas, especially those with low population densities.

3.4 Pro-poor spending

The policy of pro-poor spending has been aimed at raising growth as well as the level of productivity of assets of poor people. The share of the PAF within the medium term expenditure framework (MTEF) for poverty related activities increased from 16% in 1997/98 to 33% in 2001/02. This was deemed to be a substantial progress in terms of poverty orientation of public expenditure. Pro-poor spending has dominated spending under the PEAP pillar of improving the quality of life including spending on health, education, and water and sanitation. The government more than doubled its spending on education and health in the 1990s. Over the medium term, the shares of education and health in total public expenditure was, however, expected to decline slightly from 32.6% in 2001/02 to 31.9% and 29.6% in 2003/04 and 2005/06 respectively. Other programs aimed at improving productivity of assets include land reform. It is worth noting that Uganda does not have a large component of social spending in terms of income transfers and other related benefits.

The immediate outputs of most of these policies have been commendable as attendance of both schools and hospitals have increased following the introduction of UPE in mid 1990s and the removal of user fees in 2001. The primary net enrolment rates have been on the rise even for the bottom 20% in the rural areas. Among the bottom 20% in the rural areas enrolment increased from a low level of about 45% in 1992 to 71% in 1999 and 75% in 2003. Although the enrolment gap persists between the rural and urban areas, the magnitude of the gap continues to decline. The primary enrolment rates depict a regional dimension, with the Northern region (the poorest area of the country) lagging behind other regions. Within the Northern region, access to basic education remains limited with all income quintiles recording a decline in enrolment between 1999 and 2002. Nevertheless, these rates are well above those observed in 1992/93. The decline is attributed to insecurity in the area. The policymakers are now faced with a challenge of quality vis-à-vis quantity and ensuring secondary education for UPE graduates. There are improvements in the student-teacher ratio as well as increases in the number of qualified teachers, though all these efforts still favor the urban areas. Progress is also reported in the provision of instructional materials (Republic of Uganda, 2004).

On the whole, Ugandans are more educated today. However, gaining entry into the labor market remains a challenge. On the other hand, there has been increased access to health facilities especially by the rural population due to the abolition of cost sharing in public facilities. Communities are now closer to these facilities. The number of adult lost days due to ill-health declined for all quintiles but the number of children reporting ill-health increased especially in the bottom 20%. However, more needs to be done to ensure that the expansion in health infrastructure matches the number of trained health personnel. However, the growth impact of such policies can be elusive largely because of the inclination of such spending towards long-term impacts on the economy. Thus, in the current short to medium-term, only a little impact on growth would be expected.

In an economy characterized by a large government and a slow rate of economic growth, the private sector is likely to be crowded out, thereby shifting resources from productive investment into unproductive ones. The contraction or slow growth of the private sector will result in underutilization of assets such that the general productivity of assets, especially those of the poor, is expected to be very low. Such a development can raise the potential for social spending to have a negative relationship with growth and poverty reduction.

Recent work by Kraay (2004) suggests that government consumption is negatively correlated with both growth and distributional change.[8] The recent increase in the Gini coefficient in Uganda from 0.38 in 1998/99 to 0.43 in 2003 is an indication of worsening distributional change. Though this does not suggest a reduction in government consumption, the message is clear that some forms and/or the current pattern of government spending may not deliver the desired goal of growth and poverty reduction.

The likely channels of transmission may be based on the argument that government consumption raises the general level of consumer prices thereby reducing real private consumption and welfare. The reduction in private consumption effectively reduces general aggregate demand and hence mitigates the demand-driven aspects of the growth process. As noted elsewhere, this is one of the tradeoffs of continued use of restrictive monetary policy.

3.5 Policies affecting the pattern of growth

Over the last two decades, Uganda has implemented a number of policies aimed at revamping and stimulating industrial growth including privatization and, to a large extent, establishment of the Uganda Investment Authority (UIA). In addition, there were policies designed to stimulate structural transformation, with a view of reducing the relative role of the agricultural sector. The pattern of growth, therefore, was to follow an increasing share of the role of industry and service sectors resulting in some form of rural-urban migration, which in due course would increase the productivity in the agricultural sector. In addition, the country has also sought to pursue an export-led growth strategy with emphasis on the promotion of non-traditional export crops.

The strategy of promoting non-traditional exports has been largely successful since they account for over 50% of export earnings. However, very little sectoral transformation has occurred although agriculture continues to dominate the economy, with its share of GDP

[8] Kraay, Aart (2004), "When is Growth Pro-Poor? Cross-Country Evidence," **IMF Working Pape**r No. WP/04/47. Washington D. C.

only declining marginally over the last decade. There is a strong possibility that the decline has partly been a result of low growth rates in the sector rather than absolute increases in the other sectors.

The level of success attained by these policies aimed at altering the pattern of growth may partly be explained by the nature of implementation and possible structural rigidities in the economy. The realization of the goal of achieving sustained growth requires that programs be implemented in an efficient and effective manner. Quite often, government has taken bold policy decisions to stimulate economic growth but the implementation of such policies has been hampered by an inefficient and ineffective government service.

There appears to be so many agencies of policy formulation and implementation that the net effect on the economy may be minimal partly due to lack of harmony, competition and spreading of resources to cover overhead costs. There is a potential that the pattern of growth will be affected by the cost of the processes and institutions for policy formulation, rather than the actual implementation of the policy in a manner that would improve performance of the real sector. According to MFPED (2002), most sector programs were predominantly focused on inputs and implementation processes rather than the end results of policies, programs and projects.[9]

Secondly, though there has been an increase in the urban population, the less than proportionate response in industrial growth means that the shift is likely to deliver minimal benefits to the economy, as this will only raise urban unemployment levels. Growth in the service sector, both formal and informal may have helped to provide employment options to the increasing urban population but appear not to have been adequate given the magnitude of the migrations.

4 Tradeoffs between growth and pro-poor growth

This section explores the potential tradeoffs between policies biased towards growth and those designed to maximize the participation of poor people in the growth process. Basically, one may consider an option of focusing on continued growth within a framework that will ensure that, overtime, growth occurs with poverty reduction as more poor people get absorbed into the growth process or increase immediate spending on the poor to improve their immediate welfare and quality of life. The former (growth approach) takes a more macro inclination and would, therefore, not focus on any specific needs of micro level units.

It is worth noting that the two options are not entirely divorced from each other but too much inclination towards one option could act against the other. In Uganda, policies focused on addressing the immediate poverty concerns include the Universal Primary Education program (UPE) and free health services in public health facilities. Over the past several years policy focus has been poverty reduction, with the implication that focusing on immediate improvement in peoples' welfare may have reduced emphasis on growth.

[9] MFPED (2002), Uganda's Poverty Reduction Strategy Paper (PRSP) Progress Report 2002, 1st Draft, January 2002.

4.1 The growth approach

The option of focusing directly on the growth process largely assumes that the poor would eventually improve their wellbeing by taking up employment and business opportunities created by a growing economy. Hence, policies would be more inclined towards creation of opportunities to increase the participation of the poor in the growth process. This policy strategy is likely to be dominated by macroeconomic policies such as exchange rate reforms, stabilization and fiscal management (Henstridge and Kasekende, 2001)[10]. These were the policies Uganda followed particularly up to 1997 when UPE was introduced. Although macroeconomic stability continued as the country's priority, after 1997 there was increased focus on government spending on the social sectors – health and primary education. The growth approach was more adherently followed before 1997. From 1997, while retaining policies geared to growth, Uganda increased its focus on social sector policies that were intended to improve the quality of life of the poor through improved delivery of social services. Whether Uganda's focus on social services after 1997 occurred at some expense of economic growth is the question explored in this section.

Notwithstanding the special focus on delivery of social services after 1997, Uganda maintained almost the same policy package throughout the 1990s and in the new millennium. Emphasis was on short-term fiscal adjustments and a more proactive use of monetary policy with a view to maintaining macroeconomic stability, which was perceived as the key to economic growth and poverty reduction. The private sector, especially foreign direct investment, was expected to play a key role in the economy. As aid flows from external sources increased, government spending increased, translating into better growth performance.

The thrust of the growth approach is that the private sector leads the process of economic growth through increased investment. Foreign direct investment was perceived as a key element of the strategy. The role of the state was limited to providing an environment favorable to private sector led economic growth and provision of social services, especially to the poor. On a practical basis, the growth approach entailed maintenance of macroeconomic stability through good conduct of monetary policy. The following are some of the tradeoffs or policy dilemmas associated with Uganda's growth and poverty reduction strategy pursued from the early 1990s.

- Macroeconomic stability seems to have been achieved at the cost of high interest rates. Commercial bank lending interest rates in Uganda as of 2004 were about 30% per annum. The primary cause of high interest rates is government's issuance of treasury bills, which is done to absorb excess liquidity so as to control inflation. The widening fiscal deficit has been identified as the primary cause of excess liquidity. There is, therefore, the thinking that by gradually decreasing the fiscal deficit, interest rates would fall. Individuals and firms blame high interest rates for choking off domestic investment through reduced access to credit. Although private sector credit has been increasing, credit seems to be getting concentrated in the hands of a few firms and individuals.

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[10] Henstridge Mark and Louise Kasekende (2001), "Exchange Reforms, Stabilization, and Fiscal Management", in Reinikka Ritva and Paul Collier (eds), Uganda's Recovery: The Role of Farms, Firms and Government, Kampala, Fountain Publishers.

- Aid inflow, which is important in financing of Uganda's development process, has carefully managed using monetary policy instruments in order that it does not cause appreciation of the Uganda shilling, thereby adversely affecting export growth. There is the thinking that as a measure to reverse exchange rate appreciation, government should reduce the fiscal deficit by reducing its expenditure (possibly by cutting the contribution of foreign aid in the national budget). But cutting aid is contrary to the thinking that Uganda being a poor country needs more resources from external sources to finance its infrastructure development and other development programs that are geared towards poverty reduction. Indeed, with a view to enabling poor countries to meet the MDGs, the UN system and the richest eight countries have recently mobilized donors to extend additional aid to poor countries.

- Unanticipated inflows of foreign exchange, especially from offshore investors and private capital inflows are complicating the exchange rate appreciation challenge. Liberalization of the capital account enabled uncontrolled inflow and outflow of foreign exchange. How to apportion the causes of exchange rate appreciation between foreign aid inflows and these other inflows is one of Uganda's macroeconomic management challenges. Blocking off some of these inflows would entail reducing interest rates to remove the incentive to foreign portfolio investors to bring capital into the country for investment in the money market.

4.2 The pro-poor growth approach

The term pro-poor growth in this context is defined to mean growth that is associated with poverty reduction. This could happen in two ways: Either through implementation of policies that maximize economic growth (private sector led economic growth), coupled with public sector policies that ensure increased access by the poor to social services especially education, health, security, and water and sanitation, or through increased participation of the poor in the growth process, which would entail their increased access to productive assets particularly land, credit, and production enhancing technologies. The option of dealing with immediate poverty concerns would largely assume that the private sector provides the opportunities, in response to the creation of a supportive business environment, such that the policy focus becomes the improvement of the capabilities of the poor people for gainful participation in growth. Other policy objectives would include increasing access to, and security of, assets.

Whereas some commentators see no tradeoff between growth maximizing and pro-poor policies, it has been argued that there are tradeoffs between the two sets of policies. That increasing public sector spending on the social sectors in order to enhance participation of the poor people in the growth process lower overall rate of growth. There is also the contrary view that there are synergies to reap by implementing pro-poor policies concurrently with pro-growth polices. Uganda's experience suggests a tradeoff between the two sets of policies. Prior to 1997 Uganda followed the growth approach and the country witnessed high rates of economic growth. Thereafter the country prepared the Poverty Eradication Action Plan (PEAP) in 1997, coinciding with economic growth slowdown. However, even after 1997, macroeconomic policies still remained pro-growth with the control of inflation being Uganda's overarching macroeconomic policy objective.

The changing country environment characterized by a push for greater involvement of the masses in both political and socioeconomic decisions increased spending on expanded decision-making processes including consultations at various levels of government. One could refer to this as the 'cost of democracy' and participatory planning. Such trends clearly affected the spending trends in the country with greater inclination to provision of social services as the people, especially the poor, wanted immediate relief and improvement of wellbeing but, at the expense of real sector investments, which, though not offering short-term benefits, have a bigger likelihood of providing a more stable pattern of future growth.

Pro-poor spending was partly institutionalized through the PAF structure, which accounted for 23.3 percentage of the total budget in 2002/03, and is projected to increase slightly to 23.5% in 2003/04. Though this was a good innovation aimed at protecting expenditures that directly impact poverty, the practice tended to promote cuts in the budget of other activities that are usually complementary in the growth process. The implication is that pro-poor spending may not have been holistic in implementation, leading to less than expected outcomes.

4.3 Sector budgetary allocations

The Medium Term Expenditure Framework (MTEF), which Uganda is employing as a budget management tool, requires that an increase in resource allocation to one sector is possible only at the expense of budget cuts of at least one other sector. Increased expenditure on defense and security has in recent years entailed cutting expenditure for other sectors. The PAF areas are protected from budget cuts with a view that budget cuts should not lead to missing poverty reduction targets. However, attribution problems are encountered since non-PAF expenditures also contribute to poverty reduction or the attainment of PAF objectives. Consequently, budget cuts even of non-PAF expenditure adversely affect realization of poverty reduction targets.

From a broader perspective, increased expenditure on social sectors (education and health) has caused expenditure reduction on economic investments such as agriculture, industrial development and economic infrastructure. It is argued that economic investments pay back in a relatively short time in which case the poor could pay for their education and health following income gains from growth oriented investments. However, investment in education and health improves the productivity of people, albeit only in the long run. When resources are borrowed from external sources and there is a need to service the accrued debt, economic investment that enables the country to earn the much-needed foreign exchange looks more appealing. Thus, a tradeoff between economic investments and investment in health and education seems to exist. The tradeoff could also be in terms of long-term development aspirations (made possible by economic investment) and short-term considerations (education and health) especially when the electorate exerts a lot of pressure on government.

5 Policy conclusions

Uganda's growth and poverty reduction records demonstrate the vital importance of macroeconomic stability in promoting investments, factor productivity, domestic revenue and exports. But there are outstanding challenges in sustaining pro-poor growth that require shifting investment incentives in favor of the production of tradable goods and balancing between macroeconomic stability and public financing towards achieving the MDGs.

In pursuit of pro-poor growth, the investment strategy to emphasize is that which promotes the production of tradable goods, particularly those that have the greatest potentials of increasing the participation of poor people in growth as was demonstrated by the coffee sector during the mid 1990s. To increase the participation of poor people in this, there is need to revisit the structure of domestic investment incentives, which have largely favored the production of non-tradable goods and acquisition of financial assets, which have limited linkages to rural economic activities.

Given Uganda's dependence on aid in financing its budget deficits, it is critical that a dynamic balance between macroeconomic objectives and overall development objectives be pursued. This implies that in targeting low inflation and stable prices, it is vital that a distinction is drawn between short- and long-term objectives and impacts of macroeconomic policies. The complex relationships between monetary policy stances, short-term fiscal objectives and current modalities of deficit financing necessitate a firm focus on fiscal efficiency and aid effectiveness as pathways for lowering the cost of credit for financing the participation of poor people in growth.

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