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Challenges of Mobilising Resources to Finance Uganda's National Development Plan (NDP)

Executive Summary

A fall of global commodity prices and the resultant lower export revenues, reduction in donor financing and the increased expenditure on infrastructure have expanded the budget deficit in Uganda. In addition, the debt market is becoming increasingly costly. Interest payment on both domestic and foreign debt are projected to reach 12 percent of total public expenditures in 2017. This calls for alternative modes of revenue mobilisation. As such, Public Private Partnership (PPPs), improving efficiency in resource utilization, taxing growth sectors such as agriculture and mining, improving VAT collection and implementing policy changes to accommodate temporary macroeconomics shocks will be imperative to both mobilizing resources and financing projects planned under the National Development Plan (NDP).

Introduction

Financial mobilisation is a key bottleneck to the successful execution of Uganda's NDPs. This constraint largely emanates from the slow progress to mobilise domestic revenues and the changes in external financing architecture. Tax revenue as a percentage of the gross domestic product (GDP) stagnated, on average, at 12 percent during the NDP I period. Furthermore, the outturn of donor funding declined to 65 percent during that period.

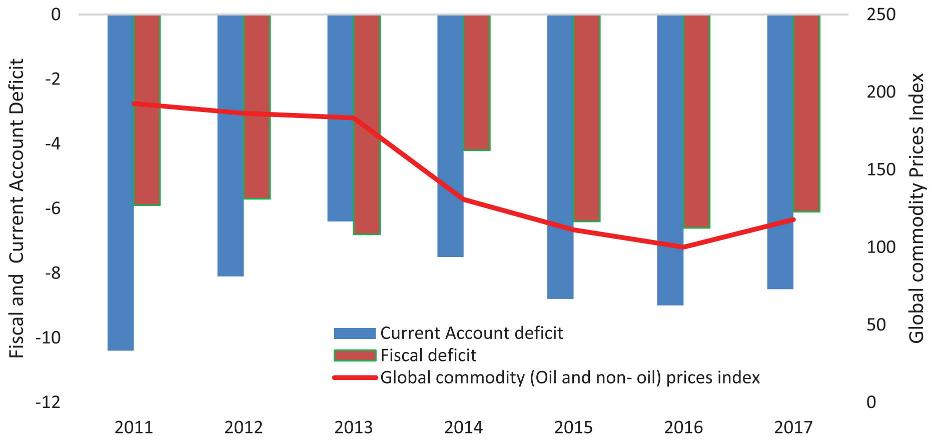
The variance between actual revenue and forecasted revenue leads to the accumulation of arrears and to sectoral reallocation of resources by way of supplementary budgets—both of which undermine budget credibility and the successful implementation of the NDP. This calls for increased domestic resource mobilization, particularly by minimizing tax exemptions such as Value Added Tax (VAT) exemptions, improvement in tax administration, harnessing the informal sector and improving the yield of the non- tax revenue resource. This brief is based on a research paper titled: "***Linking budgets to plans in a constrained resource and institutional environment: The Case of Uganda***" which examines the country's slow progress to mobilise domestic revenues and the reforms required to achieve budget sustainability and predictability.

The current and prospective Revenue positions

Macro Fiscal Outlook: A fall of global commodity prices and the resultant lower export revenues and the increased expenditure on infrastructure have led to deteriorated current account balances, and put pressure on the Uganda shilling.[1] Figure 1 shows that the current account continues to remain negative even with the commencement of NDP 2. At the same time, the government budget deficit has been expanding since 2011. The fall in commodity prices and the resulting uncertainty is bound to affect the growth in the medium term. This dampens the optimism regarding the tax potential of GDP growth and financing of the NDP. As such, a policy response is likely to be needed to support domestic resource mobilization

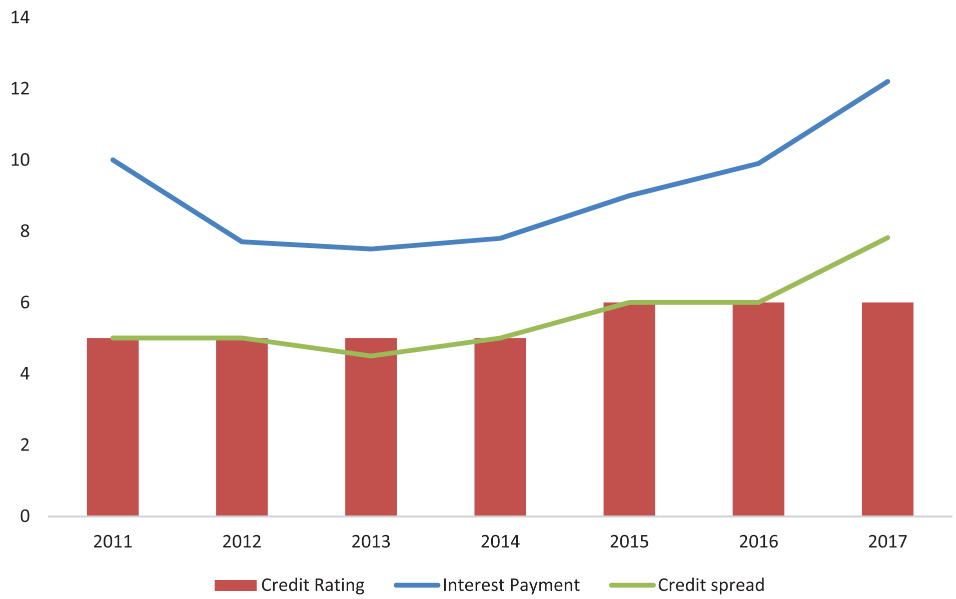
The Debt Market: Domestic and foreign borrowing can also help finance the widening current account. However, the debt market is becoming increasingly costly. Interest payment on both domestic and foreign debt are projected to reach 12 percent of total expenditure in 2017 (Figure 2). This will surpass education expenditure projected at 8 percent in the same period. While Uganda's credit rating has largely been stable, the country faced a credit rating downgrade in 2014. Lower ratings combined with higher risk premiums complicates the country's efforts to access international debt markets (figure

Figure 1: Uganda's Twin Deficit: Fiscal and Current Account Deficit (% of GDP)



Source: Authors' calculation using data from MoFPED (2016)[2] and IMF Primary Commodity Price System (2017)[3]

Figure 2: Uganda's Risk Premium (%), credit rating scores* and Interest Payment (%)+



Source: Authors' calculation using data from New York University, Stern School of Business (2017)[4], Fitch (2017)[5] and MoFPED (2016).
*Credit rating are numerical values correspond to the following credit rating categories: 7=A, 6=B+, 5=B, 4=C+, 3=C
+ Interest payments are percent of total expenditure

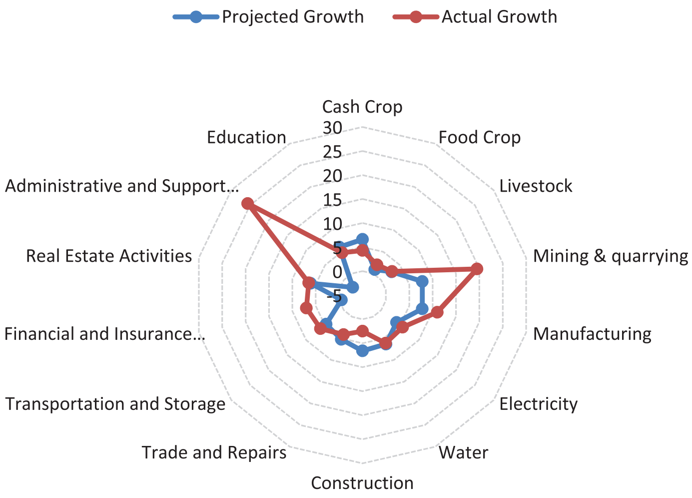
2). Figure 2 indicates that Uganda pays an average of 6 percent in cost to issue debt.

Policy Option for NDP Financing

Bankability of Projects and Private Public Partnerships (PPPs): Given the limitations in mobilizing public resources, mobilization of private resources through Public Private Partnership (PPPs) will be imperative in support of projects planned under the NDP. However, private sector's interest in financing NDP projects has been stalled by administrative delays in pre-qualification and procurement and the imprudent use of mobilised resources in some government Ministries, Departments and Agencies (MDAs), which points to the absence of institutional support to ensure sound and sustainable budgetary outcomes. This call for a comprehensive analysis of NDP projects to attract financing from the private sector. A comprehensive analysis and preparation will lower the risk to private investment in public projects, especially at the initial stages when projects are also the riskiest.[6]

Taxing Growth Sectors: Given that expenditures are expected to peak at 23 percent of GDP in 2017/18, measures targeting sectors that currently contribute a large amount to GDP but little to tax efforts will be critical. This will not only increase tax revenue yields, but also ensure efficiency and fairness of the tax system, where all citizens contribute to national development. Particularly, there is a need to ring-fence mining operations to limit subsidies to the industry, as well as the clarification of the administration of royalties. Figure 3 shows that sectors such as food crop, livestock, mining, manufacturing, electricity, water, transportation, financial and insurance, real estate, administration and support services and education performed above projected growth during the NDP 1. The continued growth of these sector could contribute more to tax growth.

Figure 3: Sectoral Growth (%), 2010 - 2015



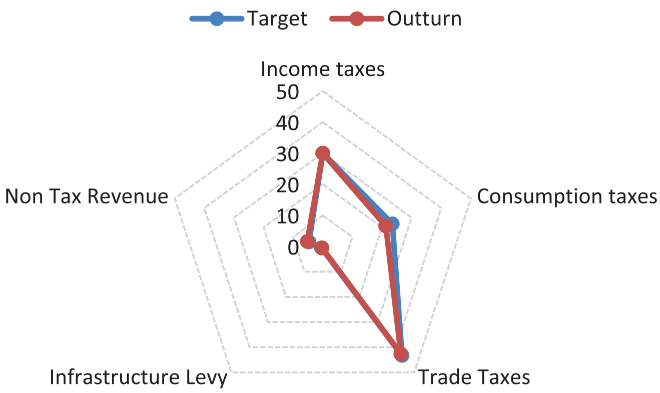
Source: Authors' calculation using data from MoFPED - Background to the Budget (2011 – 2016)[7]

The strategy for increasing revenue contribution by these sectors will largely hinge on improving revenue administration, especially with regard to measures that improve sectoral compliance. Therefore, ensuring prompt payment and monitoring avoidance will be critical in reducing under-payment and fraud. As such, enforcement of tax compliance calls for appropriate organizational structuring and allocation of administrative resources and skills at the Uganda Revenue Authority (URA).

Tax Performance: The domestic share of financing poses a major problem for the successful execution of the NDP. Tax revenues as a percentage of GDP is on averages 12.4 percent, with an expenditure of 22 percent of GDP. This implies an expenditure gap of 11.8 percentage point. In this regard, there is room for increasing tax revenue. Figure 4 shows that there is scope for increasing consumption taxes particularly by minimizing Value Added Tax (VAT) exemptions, which have compromised the effectiveness of tax collection. VAT exemptions are valued at an average of 1 percent of GDP over the first NDP. In addition, the exemptions not only complicate tax administration but also create a culture of noncompliance among other taxpayers.[8]

The intensification of the collection of VAT has the advantage of reaching the informal economy. VAT is also easier to monitor and collect using the infrastructure and administrative machinery used for custom taxes. It is not uncommon, for example, to find that developing countries collect more than half of their VAT revenues from imports. [9]

Figure 4: Tax Performance (% of total outturn), 2010 - 2015



Source: Author' calculation using data from MoFPED - Background to the Budget (2011 – 2016)

In addition, elimination of retention of taxable revenue and Non Tax Revenue (NTR) by a number of agencies is critical. Our analysis shows that Ministries Department and Agencies (MDAs) submitted only 76 percent of the 2012/13 NTR assessments. There is also a need to streamline who is responsible for collecting NTR. The legal framework does not dictate whether NTR should be submitted directly to the consolidated fund or to the Ugandan Revenue Authority.

Reforms in Rwanda are associated with increased NTR performance. The total NTR collected by Rwanda in 2014 was 9.5 percent of GDP.[10] Among the reforms implemented by the government of Rwanda to achieve this performance was the ring-fencing of mining operations to limit subsidies to the industry, as well as the clarification of the administration of royalties. NTR has also been enhanced by the control and timely submission of rent on government infrastructures, stamp charges on documents, service fees and court fines to the Rwanda Revenue Authority.[11]

Efficient Use of Resources: While mobilizing revenue is important, minimising the waste of scarce resources by improving the absorptive capacity of the 16 economic sectors is imperative. As earlier mentioned, leveraging existing resources with those of the private sector has been a popular modality of alternative financing in many developing countries. In this context, public–private partnerships fill the gap in financing development.[12] Also, given increased migration, remittances have grown remarkably as a

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source of financial support to countless families. At the same time, and recognizing the scope and stability of these flows, governments and financial institutions need to design financial instruments to tap diaspora savings and leverage remittances for development finance.

The curtailing of illicit financial flows and utilising the existing infrastructure efficiently before building new infrastructure will be an imperative strategy in the face of scarce resources. However, efficient and effective use of resources in the implementation of NDP's strategic priorities is largely dependent on the predictability of funding, which in turn also depends on the accuracy of the budget forecast. Budget inaccuracies are associated with fiscal problems such as persistent deficits, excessive debt burdens and output-destabilising pro-cyclical trends.[13]

Budget response to inadequacy of funds: In the medium term, variations between budgets and outturn call for revision of expenditures to accommodate the short falls. Permanent shock due to revenue forecast call for one for one budget cuts. On the other hand, the appropriate response to temporary shocks is to cut spending less than one-for-one, with some financial accommodations such as external financing, use of oil revenue, concessional loans and domestic borrowing (amongst other strategies) to finance the NDP.

However, expenditure cuts have significant negative effects on the efficient and effective use of resources. Experience has shown that the pruning of expenditures, especially if they are recurrent, is difficult to achieve.[14] Practices from OECD countries show that budget shortfalls, due to either changing macroeconomic or sector priorities, should be largely addressed through policy change, as opposed to budget cuts or budget increases.[15]

Conclusion

The increased need for financing of the NDP and a reduction of external financing to Uganda calls for intensification of efforts to mobilize alternative resources. The efforts should focus on improving the efficiency of use of resource, harnessing the private sector and increasing the capacity to mobilise non- tax and tax revenues. Particularly, increased efforts in domestic tax mobilisation, should purposively focus on widening consumption taxes particularly VAT coverage and improving tax administration.

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