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Uganda: A Decade of Budget Reform and Poverty Reduction

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Uganda's economy has undergone major fluctuations from a vibrant economy in the 1960s, to suffering severe macroeconomic imbalances in the 1970s and 1980s, to enjoying an economic revival since the late 1980s. A key focus of recent public financial management reforms has been to improve macroeconomic performance and ensure strict budgetary discipline, in particular through the use of a three-year rolling budgetary plan as early as 1992/93. However, problems with the cash budgeting system undermined efforts to improve budget planning, requiring complementary reforms to cash management and commitment control systems. Reforms have also focused on poverty reduction, expenditure efficiency and effectiveness, financial management and accountability, and transparency and openness.

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1. Background

Uganda's economic history has gone through four distinct episodes since independence. Between 1960 and 1970, Uganda had one of the most vibrant economies in sub-Saharan Africa. Real GDP grew at an average rate of 4.8% and GDP per capita grew at 3% per annum. The national savings rate averaged 13.4% of GDP, which was sufficient to finance a moderate level of capital accumulation amounting to 13% of GDP. The growth of manufacturing played a key role in maintaining economic growth, and by 1971 industrial output accounted for 14% of GDP.

From 1971, the situation changed drastically. The economy experienced domestic and external shocks, which were worsened by the absence of sound macroeconomic policies to address them. Productive sectors were ignored in pursuit of informal trade, as most skilled personnel fled the country to escape the economic mismanagement and civil unrest, in which they were often caught as soft targets. The breakdown of the East African Community, the rising prices of petroleum products, and the "economic war of 1972", which led to the expulsion of Asians and expropriation of their assets, further worsened the situation.

For most of the 1970s and 1980s the country suffered severe macroeconomic imbalances, including high rates of inflation and balance of payments deficits, because the growth of nominal aggregate demand consistently outstripped the growth of real supply in the economy. The main reason for this was the printing of money to finance public sector deficits, leading to large increases in money supply which fuelled high rates of inflation.

By 1980, the need to rehabilitate the economy was obvious. Structural adjustment measures, focusing on demand management, were introduced in 1981 to encourage economic growth through: realigning the value of the shilling; providing price incentives; removing price controls; increasing interest rates; and improving economic management through fiscal and monetary measures. The economy immediately responded to these adjustments. National output recovered from a –2.7% growth rate between 1971 and 1980 to 1.7% between 1980 and 1983. However, industrial production, which had initially reacted positively, then declined due to problems of foreign exchange allocations and the poor state of infrastructure. Industrial production fell by 3.9% per annum between 1983/84 and 1985/86. Agricultural production also failed to respond as anticipated because government price incentives failed to trickle down to the producers/farmers, resulting in the abandonment of the production of major export crops, especially cotton, tea and tobacco. Overall, GDP growth averaged –0.4% between 1983/84 and 1985/86.

In May 1987, Uganda embarked on an Economic Recovery Programme with support from the IMF, the World Bank and other multilateral and bilateral donors. The principal objectives were to rehabilitate the economy and enhance economic growth, to reduce inflation and to minimise the potential for a balance of payments crisis. Because of the consistency with which these measures were and are being implemented, real GDP growth rates have been positive since then, averaging 6.4% per annum from 1986/87 to 2003/04, and inflation has been contained at an average of 4.8% per annum from 1993/94 to 2003/04.

Following the successful implementation of the Economic Recovery Programme, focusing on stabilisation, Uganda also pursued more rigorous reforms of public expenditure management. The public expenditure reforms that have been implemented over the years can be broadly broken down into:

- enhancing fiscal discipline;
- focusing public expenditure on poverty eradication;
- enhancing efficiency and effectiveness of public expenditures;
- improving financial management and accountability; and
- improving transparency and openness of the national budget processes.

The aim of public expenditure reforms is to ensure efficient and effective utilisation of limited government resources in order to deliver on the overall long-term objective of eradicating absolute poverty by 2017. This article analyses the key government measures and actions undertaken within each reform category and concludes with the lessons learnt and the way forward in dealing with existing and emerging issues.

2. Enhancing fiscal discipline

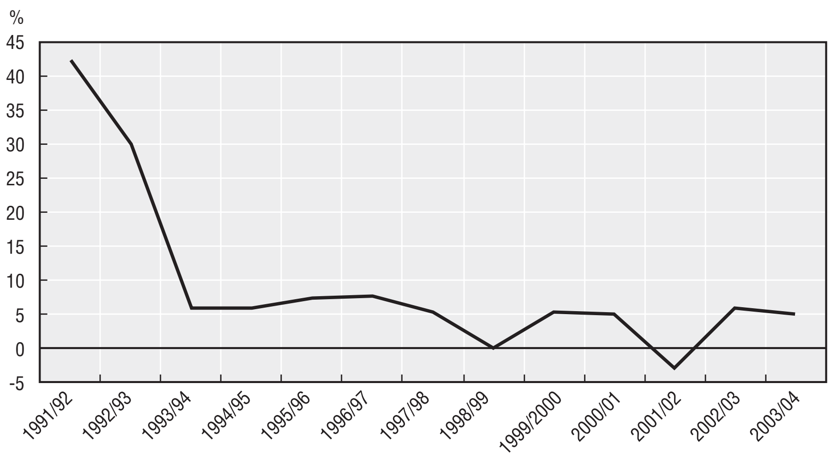
2.1. Macroeconomic objectives and performance

A sound economic framework conducive to private sector investment is the cornerstone of Uganda's growth strategy. The fundamentals required of this economic framework are low and stable inflation, a competitive exchange rate and low interest rates.

After the experiences of the 1970s and 1980s, characterised by double- and sometimes triple-digit inflation, control of inflation became one of the foundations of Uganda's macroeconomic management from the early 1990s. Experience has demonstrated that high inflation is detrimental to growth. It generates uncertainty in the economy by reducing the efficiency of the price system and also erodes the real value of financial assets, such as savings, as real interest rates become negative. This reduces investment, output and employment and therefore reduces real incomes, leading to an increase in the incidence of poverty.

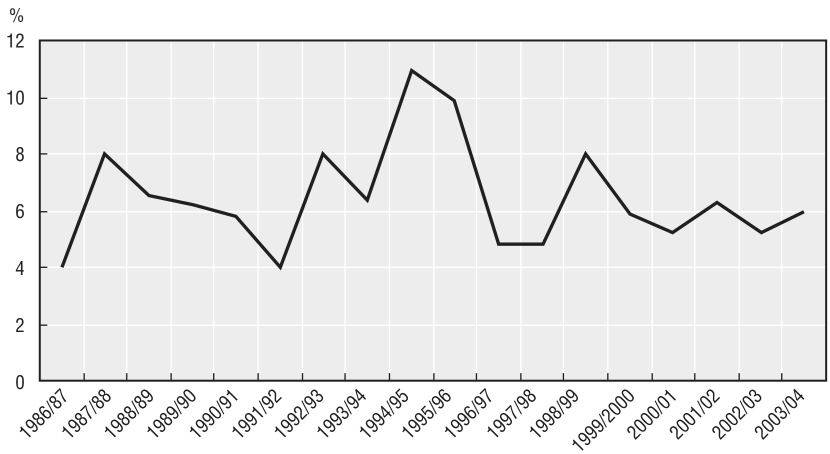
Since 1992/93 Uganda's fiscal policy has entailed very strict budgetary discipline. Government has kept firm control over its own expenditures to ensure that it does not have to borrow from the domestic banking system to finance budget deficits. Consequently, Uganda has been able to keep annual headline inflation at single-digit levels, and often below 5%, since 1993. Figure 1 shows changes in Uganda's annual headline inflation rate for 13 financial years.

Figure 1. **Changes in annual headline inflation, 1991/92 to 2003/04**



The macroeconomic stability that was ushered in by the low level of inflation immediately translated into a rebound in Uganda's real GDP growth rates (see Figure 2). This was boosted by other reform programmes such as liberalisation of cash and produce marketing channels, as well as by exchange and interest rates. Average growth since 1986/87 is 6.4%, with a peak growth of 10.9% registered in 1994/95, during the coffee price boom. Growth in total factor productivity also made a significant contribution to GDP growth during the 1990s, reflecting the scale of rehabilitation of production processes after the restoration of peace to most of the country. However, government recognises the challenge of relatively slower GDP growth in the last five years, which has averaged 5.7%.

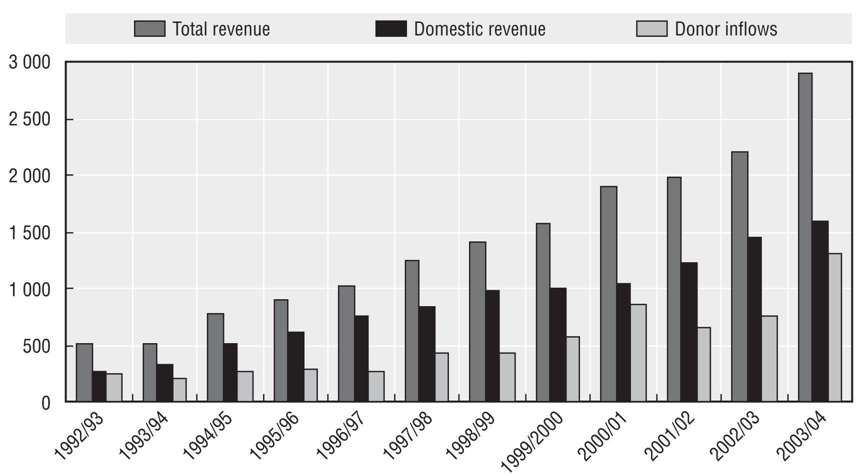
Figure 2. **Real GDP growth rates, 1986/87 to 2003/04**



2.2. Resource mobilisation and allocation

Funding of Uganda's budget, as shown in Figure 3, is split almost equally between external and domestic revenues. Inflows of external resources have been attracted largely by Uganda's record of consistent macroeconomic reforms and performance. Beginning in the second half of the 1990s, Uganda enjoyed an increase in inflows of budget support, including debt relief. Gross aid inflows increased by over four percentage points of GDP, from around 5% in 1998/99 to 9% in the last financial year. By the end of June 2004, total

Figure 3. **Composition of Uganda's total revenue, 1992/93 to 2003/04**

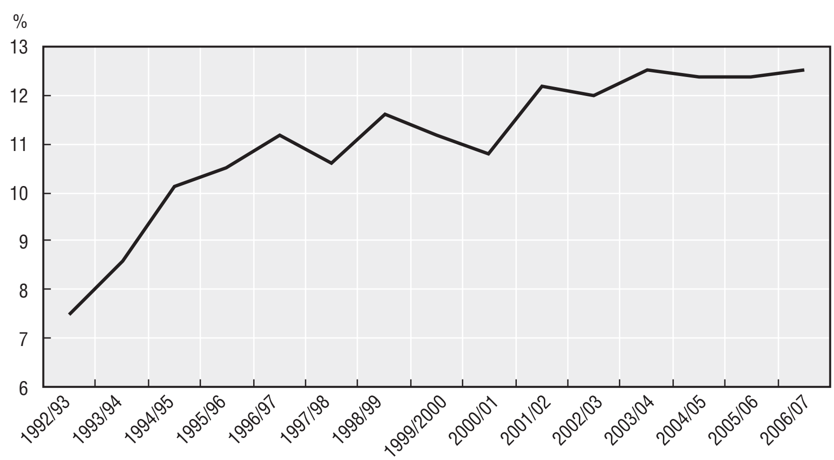


external assistance contributed 49% of Uganda's total resource envelope. With the strategy of fiscal consolidation, in order to scale back the size of the deficit, this ratio is expected to reduce over the medium to long term.

On the domestic front, the Uganda Revenue Authority (URA) was established in 1991 by an act of Parliament as a semi-autonomous body to assess and collect specified taxes, administer and enforce laws relating to those taxes, and account for all revenue to which those laws apply. The creation of such a semi-autonomous revenue collection agency was deemed necessary for an improvement in revenue collection, which by 1991 was only about 7% of GDP but rose by almost five percentage points to 11.5% in 1998 and was estimated to be 12.4% as of end June 2004.

Immediately following the creation of the URA, Uganda registered significant improvement in revenue collection; however, in recent years the proportion of tax revenue to GDP has been increasing only very modestly, as shown in Figure 4, largely due to problems with tax administration. This is exacerbated by limited opportunity for new tax measures and the recent ratification of the East African Customs Union, which has further diminished the opportunities for increasing the ratio of revenue to GDP in the short term. However, government fully recognises these challenges and has included them in its wider deficit reduction strategy by aiming to increase domestic revenues by half a percentage point of GDP per annum.

Figure 4. **Trends in the ratio of domestic revenue to GDP**

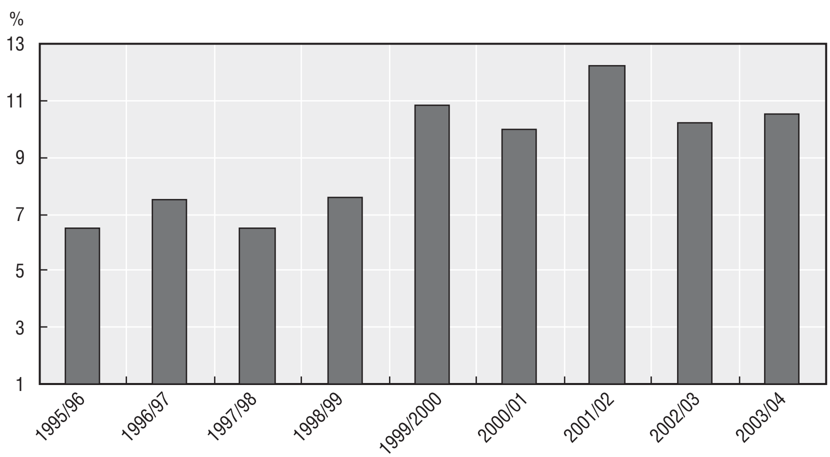


2.3. Fiscal deficit

Thus, over the years, Uganda's domestic revenues have been insufficient to fund its public services; as a result, it has relied on concessional external borrowing and donor grants to supplement its domestic revenue earnings. Because of good macroeconomic management, Uganda has received substantial donor inflows since the late 1990s. Recently, Uganda's fiscal deficit has increased as a percentage of GDP because of the increase in government expenditure, financed by donor aid inflows. Consequently, Uganda's fiscal deficit excluding grants more than doubled as a percentage of GDP over a four-year period, rising from 6% of GDP in 1997/98 to almost 13% of GDP in 2001/02.

Government believes that this level of fiscal deficit is unsustainable because of its threefold macroeconomic impact: first, the impact on relative prices in the domestic economy, in particular the real exchange rate and the cost of investment goods; second, the impact on domestic financial markets (absorption of donor funds in the domestic economy is causing instability in the financial markets, particularly in terms of high and volatile interest rates, with negative consequences for the private sector); third, the vulnerability, in the face of any significant cutback in donor aid, of a government budget that relies on donors for half of its funding, and the knock-on effect this would have on the macroeconomy.

Figure 5. **Uganda's fiscal deficit excluding grants as a percentage of GDP**



In an attempt to address these undesirable effects of large increases in donor-funded government expenditures, in 2002/03 the government adopted a strategy of fiscal consolidation with the objective of reducing the deficit gradually to 6.5% of GDP by 2009/10. This is to be achieved through increasing domestic revenues by half a percentage point of GDP per annum, and improving the efficiency of government's donor-funded expenditures by encouraging development partners to switch from project support (which is often duplicative and tends to drive up prices in key non-tradable areas of the economy, such as construction) to budget support. The deficit reduction strategy will not entail a reduction in the overall level of government expenditure or in absolute flows of donor aid, but it will require the annual growth in expenditure to be less than the annual growth of GDP. As a result of the fiscal deficit reduction strategy, the deficit has already fallen to just less than 11% of GDP.

This fiscal stance remains unpopular in many quarters. It is certainly unpopular among the spending agencies, which think that government can and should spend more. Yet fiscal deficit reduction does not mean that government will be spending less. Government spending will continue to grow as domestic revenues grow, but the stance it is adopting provides government with a much greater incentive to strengthen revenue efforts by broadening the tax base where possible and improving tax administration.

This strategy also does not necessarily mean that government's outputs will diminish, nor does it mean that government will be rejecting productive donor aid. Rather, there is a need to address the issue of efficiency and effectiveness in public expenditure and to move towards rationalisation of development assistance, redirecting it towards productive sectors. Going forward, government's preferred aid modality is budget support and, in particular, budget support grants.

2.4. The Medium-term Expenditure Framework

To enhance the fiscal discipline necessary for smooth operation of the budget, in 1992/93 government began formulating its annual budget within a three-year rolling budgetary plan known as the Medium-term Expenditure Framework (MTEF). Initially, the MTEF was a fiscal policy tool, but in 1998 it was formally anchored as a tool integrating budgeting and planning. The objectives of the MTEF are to:

- match expenditures with available resources;
- guide sectoral allocation of expenditure;
- facilitate strategic sector planning; and
- improve efficiency and effectiveness in resource use.

The MTEF sets the sector and district spending ceilings, taking into consideration the macroeconomic environment and prospects for revenue mobilisation. These expenditure ceilings are intended to provide each of the different sectors with a predictable and stable projection of the budgetary resources that will be available over the medium term, and within which the sectors can plan their expenditures. The sector spending ceilings are determined within the sector investment plans, led by the sector working groups. The MTEF integrates policy making, planning and budgeting with expenditure based on strategic priorities identified in the Poverty Eradication Action Plan (PEAP).

2.5. Cash budgeting

Among the stabilisation reforms implemented by government was the adoption of a system of cash budgeting in the 1992/93 financial year, with the objective of ensuring that expenditures are not inflationary. The instability arising from inflationary financing of public deficits by borrowing from the central bank, which characterised the 1970s and 1980s, was only contained when government imposed strict control over its expenditures. The low rate of inflation achieved since then, averaging only 5% per year compared to 110% in the 1980s, is evidence of the direct link between fiscal discipline and macroeconomic stability.

Under a cash budgeting system, shortfalls in expected resources within a fiscal year are matched by cuts in expenditure, when this is necessary for macroeconomic stability. For example, government responds to a shortfall in expected tax revenue by cutting expenditure, rather than covering the shortfall by printing money, which could generate inflation, depending on the size of the shortfall. In the case of a temporary shortfall in committed donor inflows, government responds by running down its stock of foreign reserves at the central bank to smooth the expenditure path. The starting point for a cash-managed system of budgeting is ensuring that aggregate expenditures in the annual budgets do not exceed the projected budgetary resource envelope – that is, by containing government expenditure at a level that is consistent with the money available to it through tax revenue and donor aid, so avoiding the potential for excessive borrowing from the banking system.

However, while successful in improving fiscal discipline, the cash budgeting system had severe costs in terms of the effectiveness and efficiency of expenditure. It also undermined the reforms focused on improving budget planning. With the budget being adjusted several times a year, it was less important for spending ministries to focus on their budget preparation, because of the weakened role of the up-front budget allocations in determining funding during the spending year. Also, ministries resorted to a huge build-up of arrears in the absence of cash funding; spending continued in line with the budget despite the funds not being available. These problems prompted Uganda to undertake complementary reforms to its cash management and commitment control systems, which are discussed below. These operate in tandem with the overall fiscal management system.

3. The poverty focus of public expenditure

3.1. The Poverty Eradication Action Plan

By 1995, it had become clear that Uganda's impressive macroeconomic performance was not reducing poverty as fast as policy makers desired. As a result, government resolved in 1996 to prioritise poverty eradication as the major focus of its overall sustained growth and development strategy. To this effect, the Poverty Eradication Action Plan (PEAP) was formulated after a long consultative process with a wide range of stakeholders, including government officials, members of Parliament, district administration officials, employers' and workers' organisations, donors, the NGO community, social researchers, academics and other representatives of civil society. The process was spearheaded by the then Ministry of Planning and Economic Development and facilitated by technical working groups and research in selected key areas.

The PEAP is Uganda's comprehensive policy framework for the eradication of poverty, as well as its national planning framework. The purpose of the PEAP is to guide public action to eradicate poverty. It does so by providing a framework within which sectors develop detailed plans. The PEAP was launched in 1997 and underwent its first revision in 2000. The second revision was concluded with Cabinet approval in October 2004. PEAP revisions are intended to keep the PEAP current in the light of changing circumstances and emerging priorities.

The first version of the PEAP and the revised version of 2000 had four pillars:

- creating a framework for economic growth and structural transformation;
- good governance and security;
- increasing the ability of the poor to raise their incomes; and
- improving the quality of life of the poor.

Government recognises that it is still faced with the following core challenges: restoring security, dealing with the consequences of conflict and improving regional equity; restoring sustainable growth in the incomes of the poor; human development; and using public resources transparently and efficiently to eradicate poverty. Therefore, the latest version of the PEAP comprises five main components in recognition of these challenges:

- economic management;
- enhancing production, competitiveness and incomes;
- security, conflict resolution and disaster management;
- governance; and
- human development.

Priority areas for poverty eradication are identified in the PEAP, and these guide the sector working groups in the preparation of their sector investment plans based on clear output targets, interventions and resource requirements, which can be accommodated within the MTEF. In addition, in the case of resource shortages, the Poverty Action Fund (PAF) protects priority poverty areas from budget cuts during budget execution.

3.2. Prioritisation of poverty reduction

In recent years, sector-wide investment plans have been developed in key areas, including education, health, roads, and agricultural modernisation. The plans have matched and sequenced the allocation of recurrent and development resources within the identified priorities for a specified period. Programmes spell out the goals and objectives that have a direct impact on poverty eradication, and identify cost-effective strategies and interventions by the respective stakeholders. Critical requirements and costs that can be accommodated over the medium term are also identified.

Table 1 shows how MTEF allocations over the years are increasingly focused on poverty priority areas identified in the PEAP.

Table 1. **National budget allocations by sector as a percentage of total expenditure**

	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05
	Out-turn	Out-turn	Out-turn	Out-turn	Out-turn	Out-turn	Budget
Security	19.9	15.4	13.9	12.6	14.1	10.6	11.0
Roads and works	6.2	8.1	8.5	8.3	7.3	10.4	11.9
Agriculture	1.0	1.5	1.5	2.2	2.3	3.2	3.4
Education	26.9	26.3	24.9	24.1	23.3	18.8	18.4
Health	6.5	6.5	7.4	8.6	9.0	12.4	11.3
Water	1.2	1.5	2.4	2.6	2.6	3.1	3.3
Law and order	7.2	7.3	6.5	6.7	6.9	5.2	5.2
Accountability	0.6	0.8	1.1	1.1	1.2	8.0	6.0
Economic functions and social services	2.7	4.6	5.0	6.5	7.2	8.9	9.3
Public administration	20.7	20.3	20.2	19.3	17.4	12.0	12.5
Interest payments	7.1	7.7	8.5	8.1	8.6	7.3	7.7
All sectors	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance, Planning and Economic Development of Uganda.

3.3. The Poverty Action Fund

The Poverty Action Fund (PAF) consists of a sub-set of expenditures within the MTEF which are seen as directly contributing to poverty reduction. These expenditures are funded from the same revenue sources as non-PAF expenditures; therefore, the PAF does not refer to a separate specific-purpose fund. Rather it is a virtual grouping of expenditures in the budget, linked to the priority of poverty reduction. It was set up in 1997/98 in order to channel the additional resources received under the Heavily Indebted Poor Countries (HIPC) initiative directly to poverty-reducing areas. Since that time, the PAF has expanded as donors are providing additional funds through budget support, and the year-on-year government contribution has been increasing steadily.

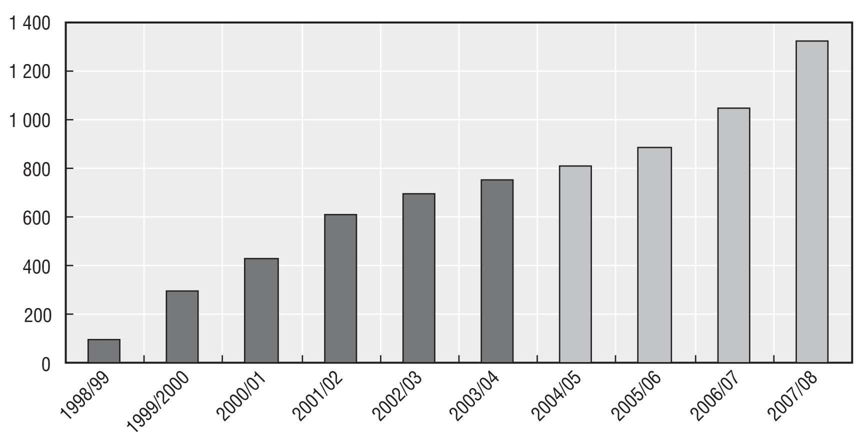
The HIPC initiative has generated substantial resources for the Ugandan budget. An average of USD 84 million per annum has been saved in the last four years, the equivalent of 21% of the average annual budget support received over the same period. Average HIPC savings are projected to remain relatively stable over the medium term.

Though the original purpose of the PAF was to create a transparent mechanism for ensuring that all resources saved from the HIPC initiative were channelled to poverty eradication programmes, the PAF has evolved into much more than this. It has attracted additional donor funding for poverty programmes over and above the regular donor programmes and, in effect, has become a mechanism for ensuring reallocation of incremental expenditures directly to poverty-reducing public services. Overall budget support in Uganda has increased more than threefold since 1998, reaching USD 451 million in FY 2003/04.

Expenditures under the fund are also managed and audited through more robust procedures. This means that scarce management capacity in the system is directed towards the most critical expenditures for poverty reduction.

Most of the growth in budget support that accompanied the HIPC initiative was the result of a shift from the traditional project support modalities on the part of donors. Government has welcomed this move, which now forms part of its fiscal consolidation strategy, because it strengthens public expenditure management and leads to more effective use of foreign aid. The trends in total PAF expenditures, as well as their projections for the medium term, are shown in Figure 6.

Figure 6. **Trends in total Poverty Action Fund expenditures (billion UGX) and projections for the medium term**



3.4. Poverty monitoring and performance

The rapid developments in the governance structures and policy arena have necessitated that the PEAP, which is also Uganda's Poverty Reduction Strategy Paper (PRSP), is revised every three years to reflect new developments. Regular revision of the PEAP is now an essential element of this process and is carried out in a highly participatory manner for maximum ownership of the policy and strategies. For example, it was revised in 2000 to take account of the findings from the "voice of the poor" in the Uganda Participatory Poverty Assessment Project, conducted in nine districts of Uganda. Findings from the Participatory Poverty Assessment (PPA) have influenced major policy changes, resulting in substantial shifts in resource allocation towards the water sector, governance issues, HIV/AIDS and justice, which are major concerns of the poor. A third revision of the PEAP has just been concluded. A PPA undertaken in 12 districts of Uganda in 2001 has formed a basis for the policy review process. Intense analytical work is already proceeding, using both quantitative and qualitative data sets.

The National Household and Budget Surveys, conducted by the Uganda Bureau of Statistics since 1992, have contributed immensely towards poverty monitoring in Uganda. The survey data sets have been extensively analysed, producing a series of poverty trends since the early 1990s. These poverty trends have continually informed government on the impact of its programmes on poverty, thus giving the timely evidence needed to guide budget policy and, in particular, the mainstreaming of gender and equity concerns in the fiscal transfers to local government.

Over the years, there has been an overall reduction in the number of people living in poverty in Uganda, from 56% in 1992 to 44% in 1997, before falling further to 34% in 2000. However, between 2000 and 2003 poverty increased slightly to 38%. The reasons for the recent patterns include a slowdown in agricultural growth during the last three years, declines in farmers' prices reflecting world market conditions, insecurity and the high birth rate.

4. Expenditure efficiency and effectiveness

Despite the increased spending in the social sectors, the attainment of the desired development outcomes remains one of Uganda's biggest budget challenges. For instance, the infant, child and maternal mortality rates have remained high and stagnant over the last five years, in spite of the increasing budgetary allocations to social sectors and good macroeconomic performance. Cognisance has been taken of the fact that efficiency and effectiveness in public spending are also important for the realisation of PEAP objectives.

4.1. Outcome and output orientation

Government is committed to refocusing budgeting and management away from the provision of inputs, towards the required outputs and outcomes and monitorable targets and performance indicators. Such a focus is expected to improve the monitoring and evaluation of government programmes.

Outcome and output orientation to planning and budgeting, supported by results-oriented management, involves the determination of the costs of the respective interventions that need to be undertaken in order to achieve specific outputs. The breakdown of costs helps to determine which are directly attributable to a given output and which are shared with other outputs. The aggregated cost of all sector outputs determines the sector budget and therefore resource allocation.

All sectors are required to ensure that their budgets are output and outcome oriented. The outputs become the monitoring benchmarks of budget implementation. Where achievement of particular outcomes and/or outputs falls under more than one sector, sector working groups are required to work collaboratively to ensure that the outcomes and/or results are achieved. Because some of the sectors, like education and health, are ministries in themselves, while others are an amalgamation of various ministries, institutions and departments, a sector's ability to identify realistic and objective outputs and to prioritise and cost them varies greatly. Reorganisation of sectors is ongoing until capacity is built for all to work in the same direction and at the same level.

4.2. The sector-wide approach

As a means of implementing the PEAP and to improve budgeting at the sectoral level, government introduced the sector-wide approach (SWAP). Its purpose has been to improve the efficiency with which government's limited resources are used, thus improving expenditure outputs. SWAPs enable sectors to take a holistic approach to budgeting, ensuring that available sector resources are allocated to costed sectoral priorities, and that duplication and wastage are minimised. Although SWAPs were first implemented in the social services sectors, they are currently being developed across all areas of government, in line with the sectors spelt out in the MTEF.

A working team of representatives from the various stakeholders (government, donors, NGOs, and so on) constitutes a sector working group, which is charged with the duty of preparing, budgeting, implementing and monitoring the sector investment plan. The sector working groups also work more widely in the MTEF and develop sector papers detailing sector achievements, challenges and policy proposals, as an input into the budget framework paper. Most of the sector working groups have been institutionalised with the day-to-day management of the business of the sector. Sectors like education, health, water, justice, and law and order have advanced in the use of the SWAP. Efforts are under way to build capacity for the remaining sectors (public administration; economic functions and social services) and to mainstream their sector activities in the existing planning and budgeting arrangement.

4.3. Rationalisation of project aid into the MTEF

Beginning this financial year, government is further enhancing expenditure prioritisation, efficiency and value for money by establishing integrated sector ceilings which reflect realistic funding for the sector. This means that both the government and donor project components of each sector's expenditure have to be accommodated within the MTEF. The purpose of this reform is threefold. First, it will enable government to control its deficit more effectively. Second, it will enable overall sectoral expenditures to be aligned with PEAP priorities. Third, it will give individual sectors an incentive to align their donor projects with their sectoral priorities.

Unless sectors are subject to a single, hard budget constraint, covering both the government and donor project components of their expenditure, they face little incentive either to limit or to prioritise their donor project expenditures, as donor projects effectively carry zero opportunity cost. The lack of incentive to limit project expenditures at a sectoral level has placed upward pressure on the aggregate fiscal deficit, which in turn has complicated monetary policy and exchange rate management. The lack of incentive to prioritise project expenditures at a sectoral level has undermined budgetary efficiency and driven up unit costs on non-tradable items such as wages.

In addition, under the existing budget system, donor projects are not subject to the normal budget controls imposed on expenditures under the government budget. For example, project expenditures do not require audit warrants from the Accountant General. This adds to the tendency for spending agencies to circumvent the hard budget constraint placed on their government budget allocation during the year by seeking donor funds directly through the project modality.

Integration of donor-funded projects into the MTEF will help government improve its management of the overall fiscal deficit, and will strengthen expenditure prioritisation at a sectoral level. In addition, it will complement other government reforms, such as development budget rationalisation. Other benefits include enabling more accurate projections of total government expenditure, which is essential for programming purposes, and better integration of planning for donor-funded projects into the annual budget process. Further, the integration of donor projects into sectors' hard budget ceilings will increase the incentive for donors to shift their aid from project support to budget support.

4.4. Fiscal decentralisation

Decentralisation of public service delivery in Uganda, as in many countries, was implemented to increase efficiency and effectiveness of public service delivery, as well as its responsiveness to the needs of local populations. The enactment of the Local Government Act of 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. Already, there has been almost 100% devolution of political and administrative responsibility to local governments, and emphasis is now shifting to fiscal decentralisation.

However, one of the key challenges is that line ministries have a great influence over the type and quality of service delivered, because of weak capacities in local government. To further strengthen the intended focus under decentralisation policy, at the same time enhancing expenditure management for effective and efficient service delivery, a Fiscal Decentralisation Strategy (FDS) was developed and finalised in 2002. Under the FDS, the present systems and processes of transfer of funds to local governments will be streamlined and harmonised while at the same time allowing local governments to exercise autonomy in decision making. In addition, local governments will be restructured in order to put in place the right structures and staff qualifications commensurate with local governments meeting the overall decentralisation objective.

4.5. Monitoring and reporting

Since 1999, public expenditure reviews (PERs) have been conducted in selected sectors and on cross-cutting issues with far-reaching policy implications. It is becoming clear that increases in public spending are not enough to guarantee either greater public access to social and infrastructural services or the desired impact on development outcomes. This recognises that public resources are unlikely to increase significantly. Government is committed to improving efficiency in the use and management of public resources, including tackling corruption. The PERs, which date back to 1995, have focused on three perspectives: efficiency of public expenditures, categorised into allocative efficiency and operational efficiency; procurement; and financial management.

The assessments have included:

- tracking studies on releases under the universal primary education system;
- teacher recruitment and deployment, and payroll management;
- the value for money of the school facilities grant;
- tracking flows of funds under the primary health care conditional grant (2001), drugs (2002), and the conditional grant for shared services (2003); and

- execution of the budget, focusing on actual expenditures *versus* the budget allocations.

PERs are very useful exercises for assessing issues of central concern with respect to local governments in the achievement of national objectives. At present, the tracking of Poverty Action Fund expenditures at the local government level is facilitated by the fact that a large share is financed through tied grants transferred to local governments. However, the reforms in fiscal decentralisation envisage a move towards a higher proportion of block grants to local governments. This is likely to make the monitoring of specific PAF expenditures more difficult, although it should enable more comprehensive monitoring systems of sector performance to evolve.

Joint sector reviews are conducted annually to review sector performance and identify areas for improvement. The reviews bring together all stakeholders (donors, government, academia and civil society) to review sector strategy in general and progress made towards development indicators, as well as issues related to allocative and operational efficiency.

For example, education sector reviews in the recent past have begun to look at sector priorities, with a view to reducing primary education's current share of 65% of the education sector budget, so as to find resources to fund technical and secondary education. Enrolment in technical and secondary education institutions is projected to grow significantly because of the increased number of students completing primary education as a result of the introduction of universal primary education seven years ago.

A follow-up action plan is formulated at the conclusion of each review or study, and implementation is ensured by integrating the sector-specific or cross-cutting issues into the relevant policy agenda.

5. Financial management and accountability

Accountability has important implications for all stakeholders who deal with government, either as funders or as recipients of services. To the extent that a government makes decisions on behalf of the people, it is necessary that it is accountable for the outcomes of these decisions. There is a strong rationale for a high degree of government accountability: it facilitates openness and understanding of what government is doing and leads to informed judgements concerning government actions.

In this context, the Ugandan government is committed to improving the efficiency of resource allocation and to tackling corruption from all angles. The initiatives involve reduction of bribery and corruption, effective detection, investigation and prosecution of offenders, and the recruitment and training of qualified staff in the accounting, procurement and auditing professions.

One of the bases for strengthening financial management and accountability in the public sector is the legal framework that prescribes the controls and administrative structures for the management and accounting of public funds. In Uganda, government has put in place various laws to enhance financial management and to promote accountability at all levels of government. These include the Constitution of 1995, the Local Government Act of 1997, the Budget Act of 2001 and, more recently, the Public Finance and Accountability Act of 2003.

5.1. The Accountant General

The office of the Accountant General (AG) was created under Section 7 of the Public Finance and Accountability Act of 2003. Prior to the coming into force of the Act, the office was referred to as Director Accounts. The AG is charged with the responsibility of compiling and managing government accounts, and providing for the custody and safety of public money and resources. These responsibilities empower the AG, according to the Act, to give general or specific instructions to accounting officers with respect to production of accounts, system of accounting, internal controls, internal audit, system of payment, custody of public money, property securities and accountable documents, and precautions to deter occurrence of fraud, embezzlement or mismanagement.

Government recognises that its existing systems do not provide a sound basis for accounting and financial reporting. Consequently, government is piloting a major reform, the Integrated Financial Management System (IFMS). The piloting began in six ministries and four local governments, and is expected to enhance the internal controls and financial reporting systems to support proper documentation and the completeness, accuracy and timeliness of reporting and reconciliation.

The reforms call for a restructuring of the office of the Accountant General to facilitate realisation of the benefits of government's investments in the Public Finance and Accountability Act and the IFMS. The restructuring is expected to promote sustainability and to maximise the opportunity for capacity building in the new skills required for enhanced financial management, treasury inspection and reporting at all levels of government.

5.2. The Auditor General

In recognition that civil servants work in accordance with the will of the executive, which is accountable to Parliament, which is accountable to the electorate, there is need for an independent and competent institution to attest to the accountability of central and local governments. In Uganda the Auditor General's office is legally instituted as an independent office that shall not be under the control or direction of any person or authority.

Under the 1995 Constitution, the Public Finance and Accountability Act of 2003, and other enabling legislation, the Auditor General has statutory responsibility to report to Parliament on the propriety and regularity of the way in which government funds have been spent. The Auditor General is required to:

- audit and report on the public accounts and all public offices including the courts, the central and local government administrations, universities and any public institutions or corporations established by an act of Parliament;
- conduct financial and value-for-money audits in respect of any project involving public funds. Sections 32-36 of the Public Finance and Accountability Act amplify the duties of the Auditor General to include examining, inquiring into and auditing the accounts of: the Accountant General; all accounting officers; all persons entrusted with the collection, receipt, custody, etc., of public money; and classified expenditure centres.

The ability of the office of the Auditor General to fulfil its mandate is currently compromised by lack of independence and limited control over its own financial and human resources. Government recognises that existing poor accountability of funds and high fiduciary risks severely limit the role of the Auditor General as a public watchdog. Efforts are under way to revise the audit legislation to ensure adequate operational independence and to mobilise technical and financial support to enhance the auditing function.

5.3. *The Inspector General of Government*

The Inspectorate is one of the oversight bodies set up by an act of Parliament and mandated to supervise and enforce the Leadership Code, promote and foster strict adherence to the rule of law and initiate public awareness programmes, as well as conduct investigations. With the support of development partners, the Inspectorate has made significant achievements in terms of its mandate; for example, the analysis of 65 asset declarations, the initiation of a verification process, and the satisfactory handling of an increasing volume of complaints and investigations.

The public awareness programme has been effective in raising the profile of the anti-corruption initiative and in advising the public on how to complain about corrupt practices. The biggest challenge is the growing public acceptance of bribery and corruption. Government is committed to intensifying its awareness programmes on the actual and opportunity costs of corrupt tendencies, and to punishing the culprits.

5.4. *The oversight role of Parliament*

Under the 1995 Constitution, the Local Government Act of 1997, the Budget Act of 2001, and the Public Finance and Accountability Act of 2003, Parliament is charged with:

- consideration and approval of the budget, spearheaded by the Parliamentary Committee on the Budget and ten sessional committees;
- scrutiny of the final accounts by the central and local governments' committees on public accounts; and
- approval of loan agreements, led by the Committee on the National Economy.

The major challenge for this arm of government is to improve its capacity and credibility as a watchdog of government activities. It must ensure that rules are enforced and must enhance the desire of all arms of government and the people to continue to obtain value for money from public expenditures. Public interest in value for money must be upheld, and the authority and capacity of other watchdog authorities should not be compromised.

A strategic investment plan has been drawn up to improve the capability of Parliament and its supporting committees and technical personnel to understand and carry out their general functions.

5.5. *The commitment control system*

The commitment control system (CCS) was introduced in 1999/2000 to help eliminate arrears, and it continues to be a landmark financial management tool that has helped reduce the creation of new domestic arrears and improve expenditure management, including enhanced accountability and financial discipline. The CCS was put in place to ensure that commitments do not exceed the ability to pay when they fall due. The CCS is also enhancing the implementation of the Public Finance and Accountability Act of 2003.

The CCS has enabled government to reduce but not to eliminate domestic arrears. In the first year of operation, a 78% reduction in arrears was realised and a further 68% was achieved the following year. Since then, the level of arrears has remained at less than UGX 10 billion, except in 2002/03 when unforeseen emergencies had to be handled (see Table 2).

Prior to the introduction of the CCS, accounting officers did not have full control over what was happening on a daily basis in their respective departments; but now, because they are appraised regularly since they approve all commitments, the CCS has given them greater insight into what activities are being implemented. The CCS has also bestowed the responsibility of transparency and accountability for public funds on vote controllers. They are now aware of the sanctions and general consequences of not controlling commitments, and are forced to exercise caution when utilising public resources.

Table 2. **Commitment Control System stock of arrears (billion UGX), 1998/99 to 2002/03**

Budget type	1998/99[1]	1999/2000	2000/01	2001/02	2002/03
Recurrent	87.000	19.000	6.000	6.400	8.894
Development	–	–	0.048	0.331	2.857
Total	87.000	19.000	6.048	6.731	11.751

1. Pre-CCS arrears.

The focus now is on making accounting officers fully responsible for the arrears created. This role is emphasised by the new legislation, which will be enhanced further with the full introduction of the Integrated Financial Management System. The major remaining challenges to the CCS are concealment of information by accounting officers due to fear of conveying a negative position of a ministry or government agency, and an inability of accounting officers to control commitments due to political pressure and unforeseen emergencies; this is characteristic of the votes linked to State House, Foreign Affairs and Uganda Prisons.

5.6. *The Integrated Financial Management System*

The IFMS is a computerised system for accounting and budgeting, which is to be implemented throughout government ministries and in some local governments. It links budgeting to financial management as a way of making output-oriented budgeting and results-oriented management operational. The IFMS is integrated in the sense that budget allocations are not broken down between recurrent and development expenditures; instead, they are linked to results or outputs. Furthermore, the IFMS electronically links local governments to the Ministry of Finance, Planning and Economic Development. Its implementation began on a pilot basis in February 2004 in six ministries and four local governments. Lessons learnt from the pilot exercise will assist in the full roll-out of the IFMS to cover all cost centres. Roll-out to the remaining ministries and seven more local governments occurred in the later part of the 2004/05 financial year.

The initial IFMS design provided for implementation of six modules covering general ledger and reporting, budgeting, purchasing, payments and accounts payable, cash management, and revenue receipting. To increase the functionality available to users, additional modules (such as fixed assets, inventory management and fleet management) will be introduced. Because the current system of government accounting is on a cash basis, there is the need for a phased change to an accrual basis of accounting so as to capture all assets and liabilities. This is part of the new requirements in the Public Finance and Accountability Act of 2003.

The expected benefits of the IFMS include enabling government to: effectively plan and control its budget; manage and report in timely fashion on its financial activities; deliver services to the public more efficiently, economically and effectively; improve monitoring and control of receipts and expenditures by accounting officers; increase internal control over financial transactions to detect and prevent potential fraud; strengthen efforts to demonstrate accountability to citizens and development partners; and reduce government's overall investment in the development and maintenance of expensive accounting systems in each ministry and local government.

6. Transparency and openness

In the past, the government of Uganda, like many other governments around the world, tended to operate with considerable secrecy. This was partly because most government agencies were monopolies and found it easy to abuse that position. In addition, there were no established institutional mechanisms to hold government accountable. However, with the restoration of basic human rights (democracy, freedom of speech, freedom of the press and a functional Parliament, among others), government is now becoming increasingly accountable.

6.1. Publication of government disbursements

With the advent of decentralisation in 1997, and given that local governments depend on the central government for 90% of their funding, tracking the release and movement of funds from the centre to the respective local governments became part and parcel of Uganda's public finance management and accountability challenges. In recognition of the fact that information is power, government adopted the use of the press to ensure that funds are not diverted, unnecessarily delayed or even misappropriated in the process of moving from the centre.

Today, central government releases to districts are published in all major daily newspapers and even announced on Radio Uganda. This increases the responsibility of the concerned officials to account fully to central government and to the recipients of the services funded by such releases. In addition, some releases are conditional on fulfilment of performance criteria. Omission of a given local government from any one month's release immediately sends a signal of the likelihood of non-compliance, for which immediate remedial action is often sought.

6.2. Consultative meetings and participation

In recent years, several reforms have been enacted in order to make Uganda's planning and budgeting process as participatory and consultative as possible. Such reforms have included the participation of civil society organisations in the formulation and monitoring of policies and programmes and, in particular, the budget process. Civil society organisations have also been involved in the monitoring of PAF expenditures at both central and district level.

To ensure that the process continues to be highly participatory, popular versions of the PEAP, the annual budget and the budget-making process have been produced to enable easy engagement with the various sections of society that should contribute to the policy/poverty debate from an informed standpoint. It is surprising to note that summarised versions of the documents have proved to be more effective in engaging parliamentarians, policy makers and implementers at central and local government level.

6.3. Budget framework papers

There are three major types of budget framework papers that are usually prepared in the course of Uganda's budgeting process. Based on sectoral plans, the sector working groups prepare the sector budget framework papers (SBFPs). In addition, local governments prepare local government budget framework papers (LGBFPs) in consultation with the centre. The SBFPs and LGBFPs inform the budgeting process by identifying all funding sources, reviewing individual sector performance, and specifying objectives and outputs to be achieved in those sectors over the medium term, given the resource constraints. Therefore, the budget framework papers are a tool for integrated planning and budgeting. Once a local government or sector, through its LGBFP/SBFP, has identified what it wants to achieve within its total funding, it is in a position to prepare its annual work plan. The work plans identify the specific activities to be carried out in each sector in a financial year.

Following the preparation and submission of SBFPs and LGBFPs, the Ministry of Finance, Planning and Economic Development consolidates and prepares the national budget framework paper (NBFP), which is then called the Macroeconomic Plan and Indicative Budget Framework Paper, in which key macroeconomic issues and sector-specific strategies are analysed. The problems to be addressed and alternative actions and procedures are all considered. Thus, the NBFP presents policy priorities, which are discussed by Cabinet to ensure that available resources can be aligned to support these priorities.

6.4. Popular versions of government documents

In order to improve participation in the national budget process, government publishes a number of popular versions of its documents. These include the Budget at a Glance, a Citizen's Guide to the Budget Process, the Budget in Brief, and the Summary and Popular Versions of the PEAP.

The Budget at a Glance is composed of three major tables: the resource envelope, resource allocation by major expenditure category, and sectoral allocation of the government budget excluding donor-funded development expenditures. The Citizen's Guide to the Budget Process informs the general public about the budget process and how it can get involved. The Budget in Brief outlines the theme of each budget, the achievements and out-turns of the previous year's budget, the policy impacts of the previous budget on the poor, the medium-term budget outlook and the specific outlook for the forthcoming budget. The Summary and Popular Versions of the PEAP summarise and present the Poverty Eradication Action Plan in simple everyday language for easy comprehension by average Ugandans.

7. Conclusion

Public expenditure reform is an ongoing process. New challenges in the rapidly changing socio-economic environment continually call for revision of government policies and programmes. As the government of Uganda forges ahead with the implementation of reforms outlined in this article, it recognises areas where reform has proved to be very challenging or is urgently required.

A ten-year public sector pay reform initiative was launched in 2001, and in the first three years of implementation some notable achievements have been made, including the reduction in pay differentials between higher-level and middle-level civil servants. Recently, Parliament was presented with a new Public Service Bill, which is consistent with changes put forward by the Constitutional Review Commission, and several proposed changes in the field of human resources management, including the devolvement of human resources capacity in local governments.

However, significant challenges remain and the progress of reform has slowed down for a variety of reasons. There is concern about the size and efficiency of the public sector and its impact on the achievement of many of the goals set out in the PEAP. In response to these concerns, the World Bank has agreed that the Fourth Poverty Reduction Support Credit policy action will be for the establishment of service delivery and the conduct of beneficiary assessments.

Government also recognises the fact that the current arrangements for funding and providing pensions and other social security benefits in Uganda are far from satisfactory, and are in urgent need of reform. A task force has been formed and charged with the responsibility of liberalising the pension sector under a Pension Regulatory Framework. This is aimed at improving the efficiency of the pension provisions and at mobilising domestic savings for long-term capital formation. However, because of budgetary constraints, it is not currently feasible for government to provide basic social security to all Ugandans, including those not in employment. The strategy in the reform process is to create a regulatory framework and an enabling liberalised pension system that will encourage new product development to meet the needs even of those in the informal sector.

There is also increasing recognition of the challenge posed by the degree of political commitment to reform. The success with which Uganda has been able to implement macroeconomic reforms and maintain a stable macroeconomic environment for over a decade has largely been a direct result of full political support for the reform efforts. However, it is uncertain what the level of support is for ongoing reforms.