



Budget Policy Brief

The 2006/07 National Budget: Shortfalls in Pro-Poor Spending

Budget Policy Brief No.1 2006

A Publication of **Uganda Debt Network**

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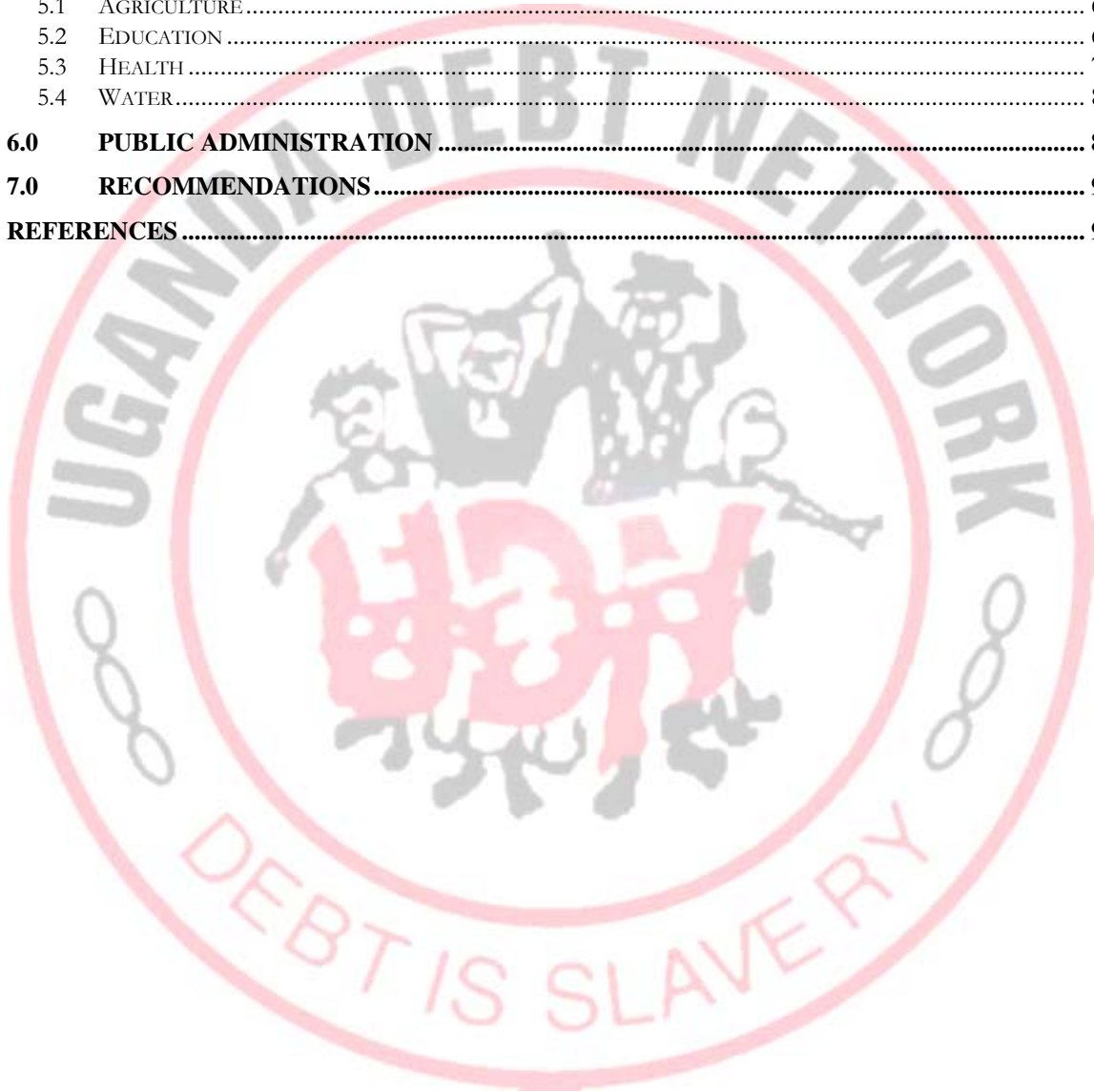
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First Published 2006

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1.0 Introduction

The 2006/07 Budget Speech is built on the theme, “Enhancing Economic Growth and Household Income through increased Production and Productivity”. The objectives are immediately relevant, especially as they build on to the PEAP’s major objective, which is to transform Uganda into a middle-income country with emphasis on industrialization based on private investment in competitive enterprises. In his Budget Speech, the Minister of Finance Planning and Economic Development (MFPED), Dr. Ezra Suruma, promises to pursue growth and development in order to increase household incomes.

The minister concludes his speech by noting: “Government has had to make hard choices in allocating resources to high priority areas and identifying efficiency savings from non-priority areas to fund the expenditure priorities. I believe that these choices will maximize national welfare and accelerate economic growth and development in Uganda.” However, the budget has some loopholes: some of the strategies are self-defeating and are lacking such that the theme of the budget, particularly enhancement of household incomes, cannot be achieved. For instance, the Minister promises to provide opportunities for enhancement of both self and wage employment but his budget proposals are short on how to achieve this.

The allocations (as percentage of the total budget) to social sectors such as health, agriculture, water and sanitation have continued to suffer cuts, while allocations to non-social sectors have continued to rise. The Minister proposes new tax measures to raise more revenue. However, most of them are not pro-poor at all; they actually favour the non-poor. It is important to ask some fundamental questions: a) how shall the household incomes be enhanced? b) Is the budget pro-poor?

A pro-poor budget should have bias towards the needs of the poor. Expenditures and tax incidences should be progressive and take the projected impacts on poor, women and other marginalized groups into account. Pro-poor budgeting principally means: a) increasing interest of the state to protect those who are poor and/or are socially and economically vulnerable; b) progressiveness in both expenditure and tax incidences of the budget mechanisms; c) incorporation of the voices of the poor in the budget process and providing feedback through transparent and accountable systems. Unfortunately, the 2006/07 Budget falls short on all the above-mentioned principles of pro-poor budgeting.

Pro-poor budgeting principles:

- ❖ Increasing interest of the state to protect those who are poor and/or are socially and economically vulnerable
- ❖ Progressiveness in both expenditure and tax incidences of the budget mechanisms
- ❖ Incorporation of the voices of the poor in the budget process and providing feedback through transparent and accountable systems.

2.0 Macroeconomic Issues

The economic outlook as presented in the Budget Speech 2006/07 has little to be proud of. Economic growth, though positive, has continued to decline from 6.6 percent in 2004/05 to 5.3 percent in 2005/06 and is projected at 4.9 percent in 2006/07. With declining economic growth rates, the country will not be to attain the 10 percent target of the number of people living in absolute poverty by 2017 as per the PEAP. In addition, it will not be possible for Uganda to meet the Millennium Development Goals (MDGs) and achieve middle-income

country status. The PEAP envisages that with a 7 percent growth rate, the country can achieve the 10 percent target, if other factors remain favorable.

Among the key causes of declining economic growth is declining growth of the agricultural sector (Table 1). Agricultural growth has continued to decline from 3.9 percent in 2001/02 to 0.4 percent in 2005/06. In addition, agricultural contribution to Gross Domestic Product (GDP) growth has ferociously declined from 1.6 percent to 0.1 percent over the same period. This clearly shows productivity constraints the sector faces. Since the sector employs over 69 percent of the population, the majority of whom are in rural areas, improvements in agriculture would be of great significance to poverty eradication.

If no action is taken to address the productivity constraints the agricultural sector faces, with a population growth rate of 2.8 percent - higher than 1.9 percent of all low income countries - and declining food crop output from 5.7 percent in 2001/02 to a mere 0.9 percent in 2005/06, a major threat to food security is imminent.

Table 1: Annual Real GDP Growth Rates; Sector Contributions to GDP and GDP Growth

Real GDP Growth	2001/02	2002/03	2003/04	2004/05	2005/06
Agriculture	3.9%	2.3%	0.8%	1.5%	0.4%
Industry	8.2%	6.7%	8.2%	10.8%	4.5%
Services	8.1%	5.7%	8.4%	8.7%	9.2%
Contribution to GDP					
Agriculture	39.9%	39.1%	37.4%	35.6%	34.0%
Industry	18.9%	19.3%	19.8%	20.6%	20.5%
Services	41.2%	41.7%	42.8%	43.8%	45.5%
Contribution to GDP Growth					
Agriculture	1.6%	0.9%	0.3%	0.6%	0.1%
Industry	1.5%	1.3%	1.6%	2.1%	0.9%
Services	3.3%	2.3%	3.5%	3.7%	4.0%

Source: Background to the Budget 2006/07

3.0 Revenue Generation: New Tax Proposals

According to the Budget Speech, total domestic revenue collections for FY 2006/07 are projected at Shs 2,566.8 billion, representing an increase of 16 percent on FY 2005/06. Government projected spending is at Shs 4,255 billion, representing an increase of 18 percent on FY 2005/06. It is clear that increase in government spending is above the increase in local revenue generation. This therefore calls for external assistance through loans and grants, which creates an undesirable situation.

Increase government spending amidst resource constraints calls for more innovative and cost-effective means of managing of resources; however, the minister glosses over this pertinent issue. The majority of the new tax proposals indicate indecision and lack of resolute action on the government's part with regard to expanding the tax base or limiting its expenditures.

Despite registering impressive economic growth (positive GDP) averaging 5% over the last decade. The share of domestic revenue to GDP has remained the lowest (about 13%) compared to other COMESA countries. The low tax base and a large informal sector, and high levels of tax evasion and corruption are to blame. In a bid to raise more revenues some

design elements of the revenue collection processes - mostly income taxes (i.e. PAYE), VAT, import duties, excise taxes and local taxes- hurt the poor more.

The poor are increasingly paying more VAT, partly because there is usually a higher rate of inflation in the part of the economy that uses low currency, which is characteristic of the commodities that they consume (CS BAG report, 2005). In addition, a number of local taxes are regressive in nature, whereby the poor pay a larger portion of their income than the rich. The poor who own small-scale businesses pay a larger portion, up to 47%, of the gross margin compared to the rich who own larger enterprises and pay only 5% (EPRC 2004)

In his speech, the minister still fails to tell us how he hopes to: a) improve tax collections and plug the holes through which the bulk of the taxes are lost; b) make taxation policy fair, just and non-discriminatory; c) make tax management less cumbersome and bureaucratic; and, d) ensure prudent management of public resources.

The new tax proposals are insensitive to the needs of the poor Ugandan population (which is close to 7 million).

The reduction on withholding tax on dividends distributed by companies listed on the stock exchange from 15% to 10% and exemption of the income of the investor compensation fund, as a measure of encouraging savings and promotion of capital markets serves to benefit the rich who can afford to own companies or buy shares. The Minister completely ignores the informal sector that employs over 90 percent of the population. Among the key critical issues that the Minister ignores is the pension reform and reduction of interest rates on lending charged by commercial banks and micro-finance institutions.

The imposition of Shs 500 per 50kg bag of cement appears a good source for additional revenue; since the construction sector has registered positive growth of over 13 percent of GDP. Yet the tax is rather too high, and is bound to stifle the growth of building and construction (including roads, schools, hospital, estates). The tax is bound to cause escalation in the price of cement, which will discourage the poor and indeed middle income earners to engage in construction business.

The increase of excise duty on non-malt beer from 20 percent to 30 percent will not only affect the consumption levels of beer in rural areas - where non-malt lager is mostly consumed - but it will also dampen the growth of the agricultural sector especially cereal growers (Sorghum and Millet). One would have expected Dr Suruma to at least raise the excise duty on malt beer (which is consumed by the rich) – like his Kenyan counterpart did - and remove the excise duty to non-malt beer, in order to encourage agricultural growth of non-traditional cash crops.

The introduction of a specific rate of between Shs 20,000 and Shs 50,000 on used (second hand) household appliances that are environmentally hazardous, without providing alternatives will not reduce consumption of used goods. This measure is counter-productive since it will only reduce their (poor people's) disposable incomes. The net effect will be reduced revenue from this source. It is important that if such measures are to be effected, there is a clear policy on import substitution and local industrial growth, so that people can consume locally made products.

The 10% environmental levy on old imported vehicles is another positive attribute of the budget. However, beyond raising more revenue to finance the budget, the revenues should

be used in cleaning and protecting the environment. Government should develop an environment fund (that is ring-fenced from budget cuts) for raising additional funds for environmental protection in a bid to address the long-term problem of deforestation and drought.

4.0 Development Budget

Whereas the major theme of this year's budget is enhancing economic growth and household incomes through increased production and productivity, the 2006/07 budget sectoral allocations are short on how to achieve this. For instance, only 17% of the budget is allocated for development spending, of which shs 134 billion is for the energy sector. This implies that without the energy crisis, the figure would have been as low as 14% (Table 2).

A detailed analysis of a number of budget estimates reveals that approximately 30% of the development budget is recurrent in nature, and/or earmarked for purpose of state-of-art four-wheel drive vehicles even under circumstances where they are not required (Prime Minister's speech during the PER Meeting, 9 June 2006). With high levels of consumption expenditures (over 80 percent of the budget), the economy will not be able to generate the required investment for economic growth and development with eventual returns on poverty reduction. A critical review of spending priorities needs to be carried out with immediate effect.

Table 2: Sectoral Budget allocations, 2006/07

Sector/ Vote	Wage	Non-Wage Recurrent	Domestic Dev	Donor Project	Total excl. Donor Proj.	%ge excl donor project
Agriculture	5.46	15.02	51.22	65.51	71.70	2.48%
Health	110.01	100.94	29.47	134.95	240.42	8.31%
Roads& Works	3.95	48.37	107.71	279.20	160.03	5.53%
Water	1.61	2.29	61.95	35.29	65.85	2.28%
Education	469.27	154.90	46.95	37.32	671.12	23.19%
Security	149.60	210.21	12.64		372.46	12.87%
Public Admin & Public Sector Mgt	121.50	321.33	24.02	35.90	466.85	16.13%
Justice/ Law & Order	68.01	80.90	27.66	8.88	176.57	6.10%
Accountability	6.65	48.54	24.81	103.54	80.00	2.76%
Economic Functions & Social Services	13.35	35.09	269.92	283.74	318.56	11.01%
Interest Payments Due		270.25			270.25	9.34%
TOTAL	949.41	1287.84	656.35	984.33	2893.81	
%ge (excl. donor projects)	32.8%	44.5%	22.7%	34.0%	100.0%	
%ge (encl. donor projects)	24.5%	33.2%	16.9%	25.4%	74.6%	

Source: BTTB 2006/07 & Author's Calculation for %ges

5.0 Social Sector Spending

In a way, pro-poor budgeting in Uganda is synonymous with social sector spending, partly as a result of indications by the poor in participatory assessments. However, a critical review of the percentage share of spending on direct poverty-reducing sectors or social sectors (education, health, water, roads, and agriculture) gives a very disquieting trend.

Table 3: Medium Term Expenditure Framework (MTEF) 1998/99 -2006/07 (total including donor project)

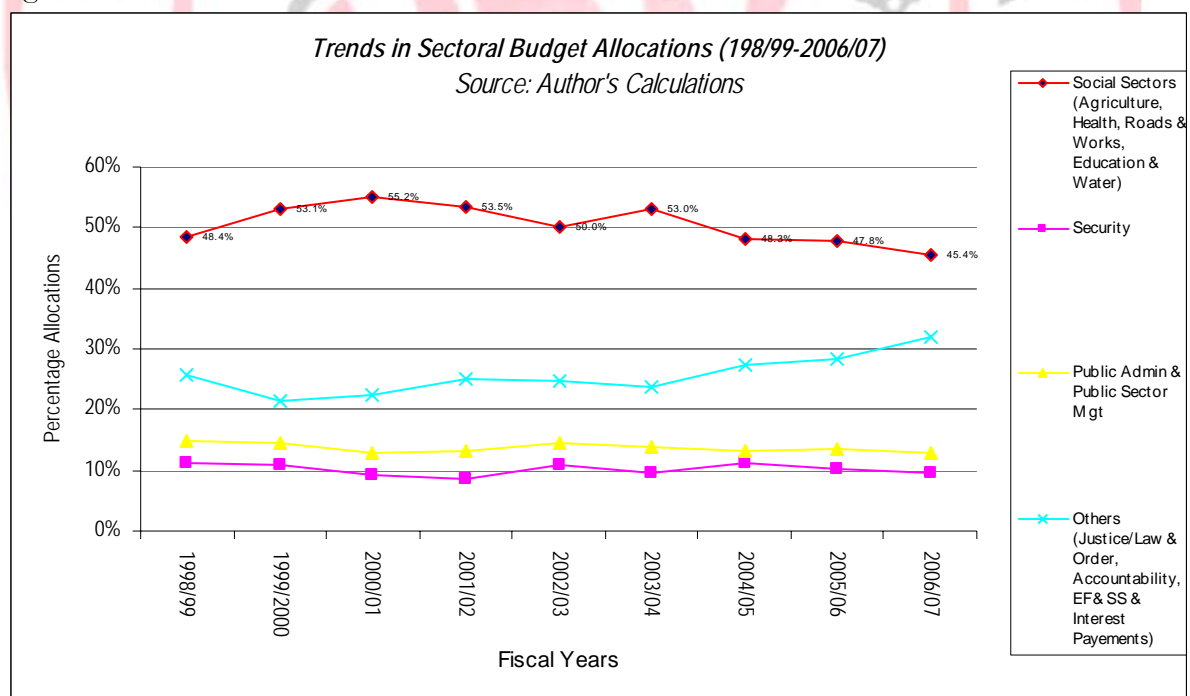
Sectors	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Agriculture	4.1%	4.4%	5.0%	4.2%	4.8%	3.6%	4.0%	3.5%
Health	11.1%	11.0%	11.6%	13.9%	12.2%	10.9%	13.7%	9.7%
Roads & Works	13.0%	13.9%	12.8%	8.2%	11.5%	11.9%	10.1%	11.3%
Water	4.6%	6.1%	5.3%	3.3%	4.6%	3.2%	3.0%	2.6%
Education	20.3%	19.7%	18.9%	20.5%	19.9%	18.8%	17.1%	18.3%
Security	10.8%	9.3%	8.4%	10.9%	9.5%	11.1%	10.1%	9.6%
Public Administration	14.5%	13.0%	13.0%	14.4%	13.8%	13.3%	13.6%	13.0%
Others	21.6%	22.6%	25.0%	24.7%	23.8%	27.3%	28.5%	32.0%

Source: Author's Calculations based on the BTTBs & Approved Estimates of Revenues & Expenditures (Various years)

Whereas the Minister re-affirms government's commitment to poverty reduction, his proposals to spend do not reflect this. The only positive attribute of the 2006/07 Budget was the increase the teachers' salaries. However, the increment was done at the expense of other sectors - such as the health sector – which suffered budget cuts. The health sector budget was reduced by 26% from Shs 508.66 billion in 2005/06 to Shs 375.38 billion in 2006/07.

Despite increases in government spending (projected at 17% this financial year), spending on social sectors has continued to decline from 55% of the total budget in 2000/01 to 47% in 2005/06 and it is expected to decline further to 45% in 2006/07. Apart from education, all other social sector budgets have indexed decreasing shares from 11% to 9.7% for health; 6.1% to 2.6% for water; 4.4% to 3.5% for agriculture; and, 13.9% to 11.3% for roads and works between 2000/01 and 2005/06.

Figure 1

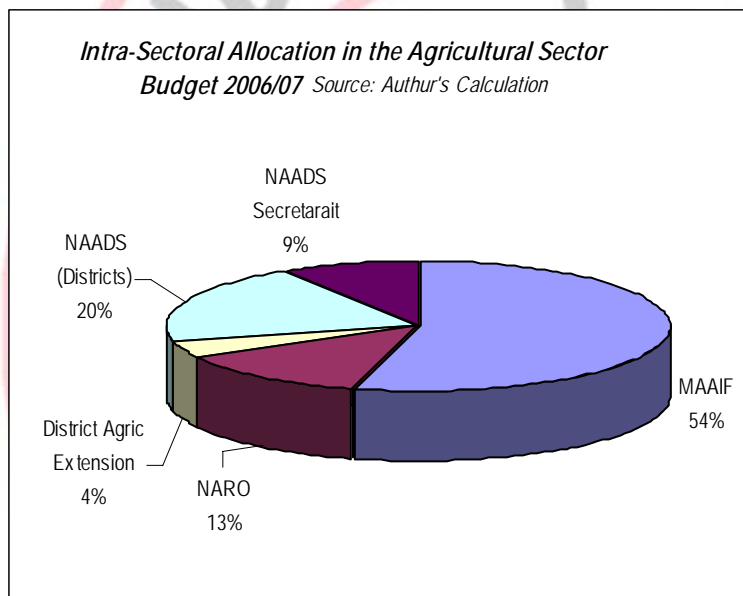


5.1 Agriculture

It is a pity that interventions in agricultural development have remained rhetorical. Allocation to the agricultural sector in the national budget continues to suffer unprecedented cuts i.e. from 4.0% (Shs 148.85 billion) in 2005/06 to 3.5% (Shs 137.21 billion) in 2006/07. A close examination (*see figure 2*) shows that even with the Shs 137.21 billion, only 24% of this is spend at local government levels.

The Minister proposes only Shs 9 billion (on NAADS and rural development), as a genuine intervention to address the plight of the poor, and especially those engaged in agriculture. However, this intervention is too skimpy to address agricultural productivity constraints, especially those related to externalities like pests and disease control. In addition, the slow pace in the implementation of the Plan for Modernization of agriculture (PMA) and its key sub-components is evidence of practical challenges of reducing rural poverty.

Figure 2



As long as the national budget does not lead to sufficient growth in the agricultural sector, there is no way any level of general economic growth will generate and sustain poverty-reducing impacts. In a poor country such as Uganda, a strategy that gives agriculture development paltry resources is definitely not pro-poor.

5.2 Education

The provision of educational services is key to improving the quality of life of the poor. We appreciate government efforts to improve the welfare of primary teachers (by increasing their salaries from Shs 150,000/=to Shs 200,000) and increasing focus on primary education. However, we are concerned about the declining trends (as a percent of the total budget) the sector has continued to experience from 20 percent in 2000/01 to 18 percent in 2006/07.

The introduction of Universal Post Primary Education and Training (UPPET) in 2007/08 is step in the right direction. However, for UPPET to succeed (just as UPE has done on increasing enrolment of pupils in primary schools) it must be built on a properly planned policy in form of a White Paper that is discussed and agreed on by various policy makers and organs.

5.3 Health

Health is a key element of social and economic growth, and it is one of the major sectors that can directly impact on poverty eradication. Despite, substantial increases in funding the sector; health outcomes have not been impressive. For example, between 1995 and 2001, infant mortality rates, child mortality rates, maternal mortality rates, stunting and malnutrition have all deteriorated (Table 4).

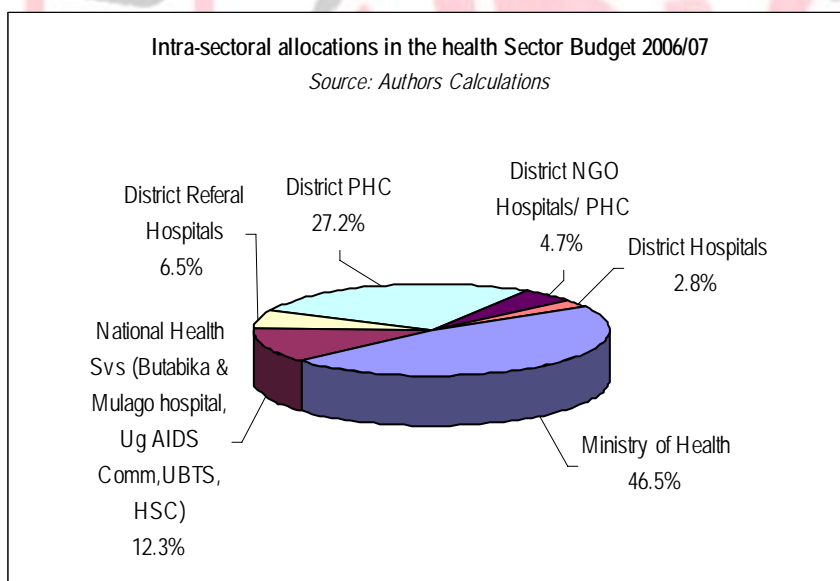
Table 4: Health-related outcome indicators

Indicator	1995	2001
Infant Mortality Rate (per 1,000 live births)	81	88
Child Mortality Rate (per 1,000 live births)	147	152
Maternal Mortality Ratio (per 100,000 deliveries)	527	505
Malnutrition-stunting	38%	39%

Source: Poverty Status Report 2005

The sector requires more than double the current spending in order to realize the minimum health care package (MHCP) of \$ 28 per capita. Currently government spending on health per capita is \$ 9. Unfortunately, funding to the sector has continued to decline from 11 percent in 2000/01 to 9.7 percent in 2006/07. This is causing persistent inadequacies in the production, recruitment, and deployment of trained personnel, frequent stock-outs of essential medicines and health supplies and lack of equipment for operationalising the new health centers.

Figure 3



A review of the intra-sectoral allocations within the sector (Figure 3) shows that over 58 percent of the spending is on the national level health services, with the Ministry of Health taking over 47 percent. Spending on health services at local levels where the majority of the population live is only 40 percent. It is important that the sector puts more focus

in activities that will bring change in people's lives, especially those at local government levels.

The sector needs to give increasing priority towards significantly improving hygiene and sanitation at the household levels. Budget allocation to sanitation need to be increased substantially.

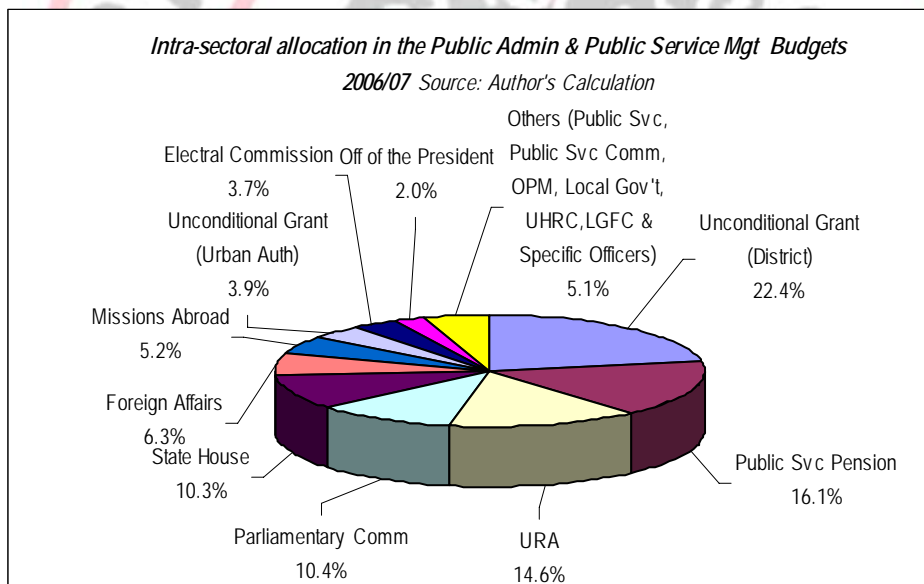
5.4 Water

Water has been cited by the poor as one of the key requirements for welfare enhancement in the fight against poverty. The increase in safe water coverage in both rural and upcoming towns is encouraging. Indeed, there has been an improvement in the percentage of the population with access to improved water sources from 44% in 1990 to 54% in 2002. However, there was a fall in the proportion of the population with access to improved sanitation facilities that from 43% in 1990 to 41% in 2002. Generally, the proportion of the population with access to safe water and improved sanitation is still low; so the reduction in the budget share of this sector from 3.0% in 2005/06 to 2.6% in 2006/07 may hinder development in this sector. Besides, the sector still faces a challenge of increasing accessibility to, and improving the functionality of water sources.

6.0 Public Administration

Despite the efforts by government to portray the costs of running government as reducing through introduction two sectors: Public Administration and Public Sector Management, the combined expenditure of the two has continued to escalate, standing at over 16 percent (excluding donor projects) in 2006/07 (see table 2).

Figure 4



It is true these sectors are core in the running of the government; but their roles have been exaggerated and at times duplicated. Several uneconomical districts have been created in the name of “bringing services nearer

to the people” and a number of ministries have been established yet with duplicated roles. As seen in Figure 4, unconditional grants to districts, public service pension, Uganda Revenue Authority, Parliamentary Commission, State House, Foreign Affairs and Missions Abroad have continued to take the lion’s share.

Besides getting the second biggest share of the budget, the sector is usually noted as the leading cause of budget indiscipline across government. The PEAP 2004 (page 188) notes that ‘Budget implementation has been damaged by lack of budget discipline in some ‘powerful’ ministries, especially in the public administration and security sectors, which have persistently overspent their budget estimates’. Consequently, less powerful ministries and agencies continue to suffer budget cuts to their operational and development budgets.

In order to enforce budget discipline, government needs to shun political rewards but instead emphasize optimal resource allocation so as to achieve growth and development. Cost-effective methods (such as avoiding creation of new districts; reducing the number of ministers, parliamentarians, commissions of inquiry; stopping acquisition of state-of-art expensive vehicles; reducing the running of business through workshops and seminars) of delivering services to the people should be devised.

7.0 Recommendations

In order to realize the PEAP objectives and the Budget theme of increasing households' incomes and productivity, Government should:

- ❖ Prioritize sectors according to their contribution to growth, and hence reallocate resources with a bias towards agriculture, health, education, water and sanitation and roads. Special attention should be given to improving outcomes in the health and water sectors.
- ❖ Reduce its administration costs by reducing the size of parliament, cabinet, ministries, and creation of new districts.
- ❖ Develop clear monitoring and evaluation frameworks beyond outputs (financial audits) to include value-for-money audits as a way of reducing wastage of public resources, corruption and embezzlement.
- ❖ Employment and wealth creation should be given priority.
- ❖ Review some of the tax proposals especially on malt-beer and cement since these are likely to have negative impact on the poor people.
- ❖ Develop a clear policy and regulatory framework with concrete funding plan for nature and environmental conservation.
- ❖ Agriculture, just as education and health, should be accorded a high priority status. Consequently, funding the agricultural sector should be increased as part of Government's commitment to the Maputo Declaration.

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