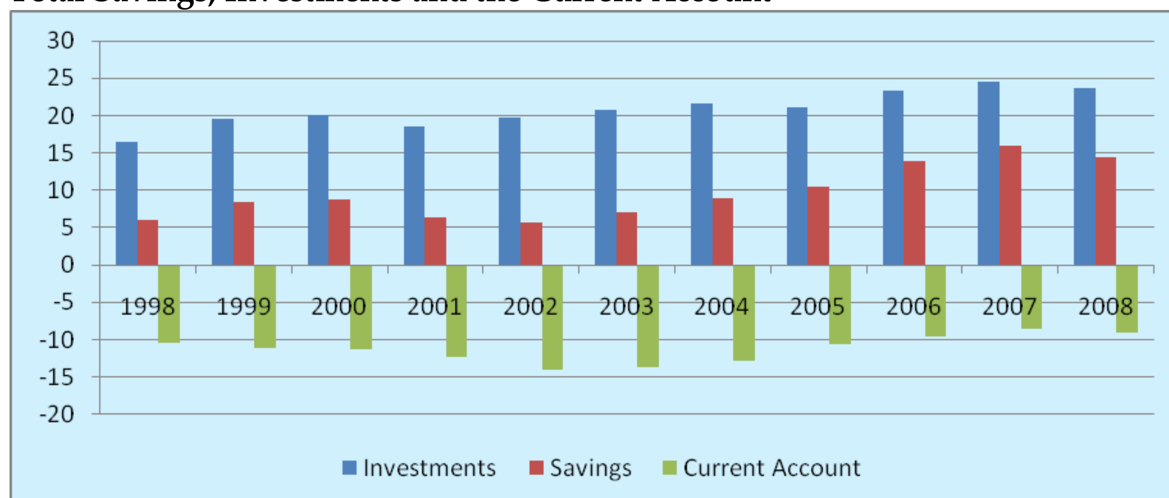
Domestic Resource Mobilization in Uganda
Policy Note

Introduction

During the period 2000-2008, Uganda's growth rate has been very impressive. Estimates show that average GDP growth rate (at factor prices) for the five years(2003/04-2007/2008) was as high as 7.9 per cent, with the economy posting a growth rate of 8.9 per cent for the year 2007/2008. However, growth decelerated owing to the financial crisis during the period 2008/09 to 7.1 percent. The global recession impacted the economy through (i) reduction in foreign financial inflows including aid, grants, foreign direct investment and remittances; (ii) depreciation of the exchange rate, and; (iv) reduction in commodity prices of major exports of goods that are exported beyond the region.

Albeit the unprecedented growth, Uganda likes many Sub-Saharan African (SSA) countries has the lowest savings rate of any developing region. In 2005, gross domestic savings in the SSA region averaged 18.0 percent of GDP, compared with 26.0% in South Asia, 24.0% in Latin America and the Caribbean, and nearly 42 percent in East Asia and Pacific countries (World Bank, 2007a). Savings in Uganda have remained generally low compared to other regions. While savings have remained low, they have been on an increasing trend growing from 5 to 15 percent of GDP during the period 1998-2008.

Total Savings, Investments and the Current Account



Key Policies to Increase Domestic Resource Mobilization

(i) Widening the tax base by targeting the informal sector

Uganda's tax base remains very narrow compared to other countries in the region. Tax revenues have stagnated at 13 percent of GDP albeit all the reforms that have been implemented to increase tax revenues. For Uganda to meet its development challenges, the key policy objective is to widen the tax base. This can be done by implementing the following:

Tapping on the informal sector. The URA should make an effort of targeting businesses and commodities that are under-taxed. For instance, the VAT system has not been fully implemented at the retail stage. The bulk of this tax is collected on imports and large whole sellers and manufacturers. By registering all informal traders for VAT on the commodities they trade in, this would expand its coverage.

Streamlining of tax incentives: Tax incentives are politically much more difficult to completely remove. Given the cost of tax incentives to the ability to collect taxes, the government should make an effort to streamline these incentives in its quest for attracting investors. This should be done by undertaking due diligence on the benefits and costs of the investments vis-à-vis the revenue foregone.

Implementation of the National Identity Card: To identify the small informal businesses, it would require implementation of the National Identity Card where an individual or business (small or big) can easily be tracked. In addition, URA would need to undertake a special survey to establish the potential revenue that is not currently paid by small enterprises.

By undertaking these measures, it is estimated that this could result into revenues increasing by at least 3 percent of GDP.

(ii) Introducing new tax handles

The available tax handles do not adequately capture the recent developments especially the emerging middle class whose income and wealth created has not been taxed. With the abolition of the graduated income tax which was considered to be regressive, there is need to replace this tax especially for the local governments not to be totally reliant on central government transfers. Some of the tax handles that could be introduced include:

Implementation of the presumptive taxes: While this tax already exists, its implementation has been weak. Presumptive taxes would largely address the

weaknesses associated with small enterprises not keeping financial records. The tax mainly relies on turnover.

Introduction of a Property Tax: This tax should mainly be levied on residential and commercial properties. It is highly progressive and can be used to finance especially the local government development programs.

The role of donors in this case would mainly be to provide technical assistance on how such new tax handles can be introduced and providing the best practices on how these types of taxes have worked in other countries.

(iii)Development of financial instruments to provide long-term financing

The key challenge for Uganda to address its development needs is the unavailability of long-term financing. This constraint has also been recognized in the National Development Plan for 2010-15, which highlights the challenges for the development of the financial sector. Some of the steps that could be undertaken to address this problem include:

Increase availability of development finance for investors in priority sectors of the economy. This would entail recapitalization of Uganda Development Bank (UDB), as well as ensuring that systems and procedures are in place for proper functioning of these institutions. The Donors could in this case play a role by providing lines of credit to UDB which can then be lent to other sectors.

Encourage opening of alternative sources of long term capital. This would entail liberalizing of the pension sector and working on governance problems with the National Social Security Fund which currently is the largest pension fund for individuals working with private sector.

Mortgage financing to encourage collateralization of loans and mobilization of savings. The current mortgage market is still very shallow and limited with the availability of long-term financing. Banks should venture into accessing long-term financing as a way of diversifying their products.

To undertake these objectives, Uganda would have to work very closely with its development partners. In particular, technical assistance would be required from institutions like the IMF and World Bank on how to diversify into other financial instruments with the objective of providing long-term financing. In addition donors should strengthen their focus on providing long-term financing by on-lending to viable financial institutions.