

Domestic Resource Mobilization in Uganda and Economic performance

John Mary Matovu¹

Abstract

This paper discusses possible approaches for improving the mobilization of domestic resources for development in Uganda focusing on the interrelationship between domestic saving, government revenue, capital accumulation and economic growth. In particular, it highlights the possibility of creating a virtuous cycle of higher domestic saving and investment rates, and higher trend growth. Key policy areas for achieving this are the development of domestic financial sector. Improving financial intermediation can be a key factor for raising the level of domestic savings and for their efficient channeling into growth-enhancing investment. However, financial deepening has to reach a certain level before the financial system can intermediate efficiently in channeling savings into productive investment. Hence, assigning high priority to financial reforms in the economy, especially in a country that has not made sufficient progress in this area, may have a mutually reinforcing effect on domestic savings, investment and growth. Another key policy reform area is the strengthening and widening of the revenue base which is still very small compared to other countries in the region. This would also entail enforcing new tax systems and widening the tax net to the largely untaxed informal sector.

Keywords: Domestic Resource Mobilization, Taxation and Financial Intermediation

JEL classification: xx,xxx,xx

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¹ Economic Policy Research Centre, jmatovu@gmail.com

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1 Introduction

Both the theoretical and the empirical economic literature emphasize the role of national savings in influencing the pace of fixed investment in an economy and its overall economic growth rate. The concept of saving plays an important role in economic analysis. Saving is defined as the difference between income and consumption. The relationship between savings, investment and growth has been thoroughly analyzed in the theoretical and empirical literature. As suggested by endogenous growth theory by Romer (1986) and Lucas (1988), high savings and investment rates are important in view of their strong and positive association with the GDP growth rate. The empirical evidence (see, for example, Levine and Renelt, 1992) also indicates that there exists a robust positive correlation between the investment rates and GDP growth. The conventional wisdom about these links is that thrift is a major determinant of long-term economic growth, which in turn is related to the conjecture that in the long run there must exist an expected positive return on the invested capital, regarded as the reward for parsimony.

The extent to which the level of savings can affect capital accumulation, and hence growth, largely depends on the capacity of the economy to channel the savings into productive activities. It also depends on the efficiency of this process. The system of financial intermediation can affect economic performance and growth directly through the role it plays in resource allocation. In particular, the financial system can affect saving and investment decisions by reducing information and transaction costs, creating mechanisms of risk-sharing, facilitating trade and payments among economic agents and providing various supporting services. Efficient financial intermediation channels savings into the most productive investment projects, and thus contribute to higher rates of aggregate growth. Conversely, inefficient intermediation may reduce the allocative efficiency of resources, which ultimately could result in lower rates of aggregate growth. However, a well functioning system of financial intermediation can also affect economic growth indirectly through its positive impact on the level of national savings, by allowing the mobilization and channeling of larger amounts of resources into productive use given the conventional wisdom, that capital accumulation drives growth. Under these assumptions, an initial rise in the level of national savings may drive the economy to a more stable equilibrium of higher growth.

In the period 2000 to 2007, Uganda continues to enjoy notable improvements in social and economic well being. The Ugandan economy experienced robust 6.0% growth in 2006/07, rebounding from the slowdown in 2005/06. Economic growth in 2006/07 was driven mainly by good performance in the services sector, which registered a 9.5% growth rate compared to 5.8% growth for industry and 1.8% for

agriculture (Table 1). Albeit this impressive growth rate, Uganda's savings rates remain very low compared to its investment needs. Savings to GDP ratio have staggered between --- and --- percent. And the reason for this poor performance can be attributed to two factors: (i) weak financial system (ii) small tax base for the public sector.

This paper attempts to highlight the key binding constraints for the public and private sector to mobilize resources. For the public sector, the main constraints identified include: (i) Low incomes and widespread poverty, (ii) large inform sector which is difficult to tax, (iii) large agriculture sector which is untaxed, (iv) corruption amongst tax collecting agencies, and (v) generous investment incentive structures. On the other the financial sector remains constrained as a conduit for financial intermediation owing to the following factors: (i) undeveloped financial markets with limited financial products, (ii) uncompetitive banking system with limited penetration in rural areas, (iii) short maturity structure of most financial products, and (iv) high interest rate spreads.

The key recommendations of the paper include: (i) tapping on the informal sector to widen the tax base, (ii) complete abolition of tax incentives, (iii) implementation of the National Identity Card, (iv) implementation of the presumptive taxes, (v) introduction of a property tax, (v) further simplification of the tax system. For the financial sector to a an efficient conduit of financial intermediation, the following measures could be implemented: (i) Strengthening and expanding financial institutions and markets especially in rural areas (ii) Increase availability of development finance for investors in priority sectors of the economy. (iii) Encourage opening of alternative sources of long term capital, (iv) Develop Mortgage financing to encourage collateralization of loans and mobilization of savings, Strengthen the Credit Reference Bureau (CRB), (v) Modernize the land and company registries as a means of hastening the process of extending credit, and (vi) implementing the pension reform act which would entail making the sector more competitive and provide long-term financing for the financial sector.

The rest of the paper is structured as follows. Section 2 provides an overall background for the Ugandan economy. Section 3 provides a historical perspective of how Uganda has performed in mobilizing savings. Section 4 gives a summary of the status of the financial sector. Section 5 focuses on public sector revenue mobilization and taxation policy in Uganda. Sections 6 and 7 provide the binding constraints to savings mobilization and the available opportunities to generate higher savings. The conclusion is in section 8.

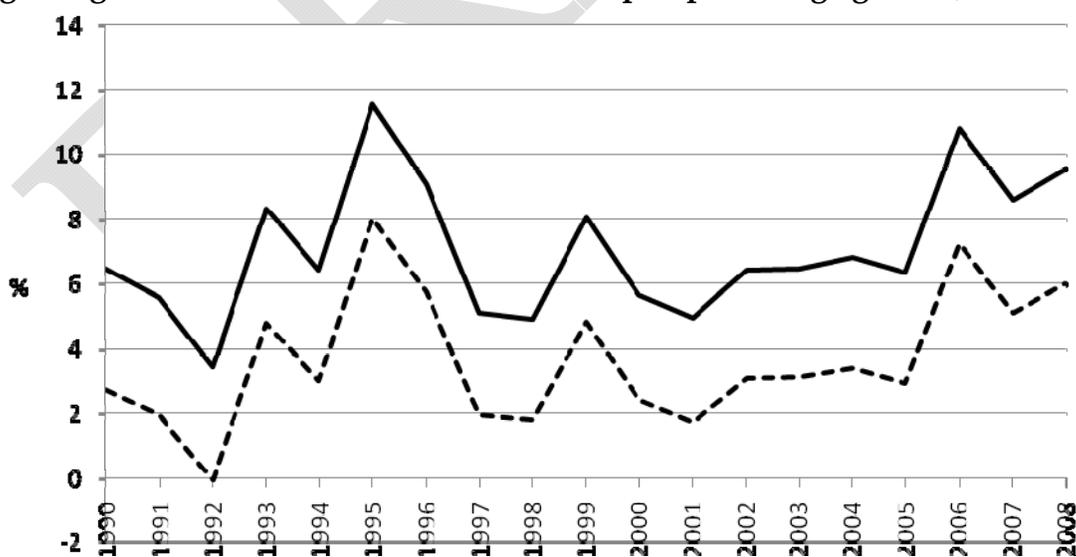
2 Background to the Ugandan Economy

2.1 Growth Performance

The period 1990-2008 involved two phases of growth one 1990-1999 and the other 2000-2008. The 1990 to 1999 phase was characterized by sustained positive growth rates far above the Sub-Saharan average. At an average of 3.6 per cent, Uganda's per capita income (measured in 1985 international prices) recovered from the low of US \$ 504 of 1986 and had reached US \$ 697 by 1997. The Uganda Bureau of Statistics estimates trend growth over this period at about 6.8 per cent per year with all sectors of the economy growing relatively fast during the period 1990-1999.

Similarly, the period 2000-2008 was very impressive. For example, estimates by the Uganda Bureau of Statistics 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. But the economy grew only at 6 per cent in 2008 due to the turmoil in the world economy and regional instability. The global recession has impacted the economy through (i) reduction in foreign financial inflows including aid, grants, foreign direct investment and remittances; (ii) depreciation of the exchange rate (as a result of (i)); (iii) changes in exports to the region, and; (iv) changes in exports of goods that are exported beyond the region. Consequently, growth may slow in 2009 to about 5 per cent given this combination of internal and external shocks.

Fig. 1: Uganda Annual GDP and GDP Per Capita percentage growth, 1990-2008



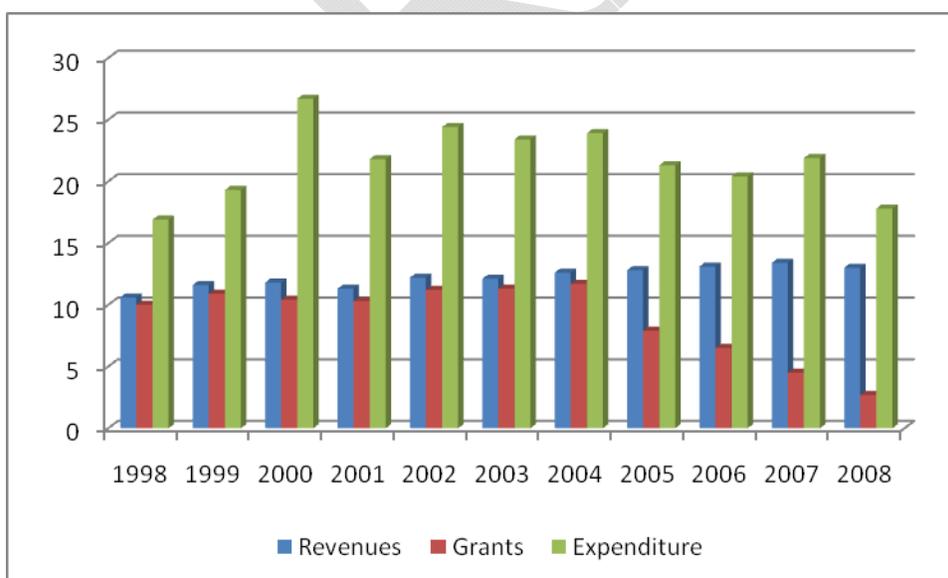
Source: World Development Indicators, World Bank, 2008

Uganda's strong economic growth since 1992 has been driven mainly by the services, manufacturing and construction sectors. In 2008/09, the share of value added contributed by the services sector was almost half of total gross domestic product (GDP) from about 32 per cent in 1990 and that of agriculture diminished steadily from 50.3 per cent to about 15.2 per cent in the same period. The industry sector (manufacturing, construction and mining) share in GDP has increased from about 1 per cent in 1990 to about 24.2 per cent in 2008/9. However, its growth was slowed down in 2008/09 by the effect of the global economic crisis, growing only by 3.8 per cent compared to 9.1 per cent the previous fiscal year (MFPED, 2009). This was mainly due to the slowdown in the construction sector due to the drop in remittances that has hitherto fuelled a construction boom in the country. This slowdown was also due to the increase in imported inputs arising from the depreciation of the Uganda shilling².

2.2 Government and/or non-financial public sector accounts

Due to the turbulences that characterized most of post-independence Uganda, tax collections have historically been low. For example, the tax to GDP ratio that stood at 12.6 per cent in 1970-71, had declined to a dismal 6.5 per cent by 1989/90, leading to large deficits and a budget mainly funded by external financing (Ayoki, et.al. 2004). Revenue performance has since improved, peaking at a tax/GDP ratio of 15.8 per cent in 2006/07 before declining slightly to 13.1 per cent in 2008/2009. This is still below the Sub-Saharan Africa average of about 20 per cent and is lower than that of its neighbours. In Tanzania, tax revenue was about 17per cent of GDP and about 27per cent in Kenya for the same period.

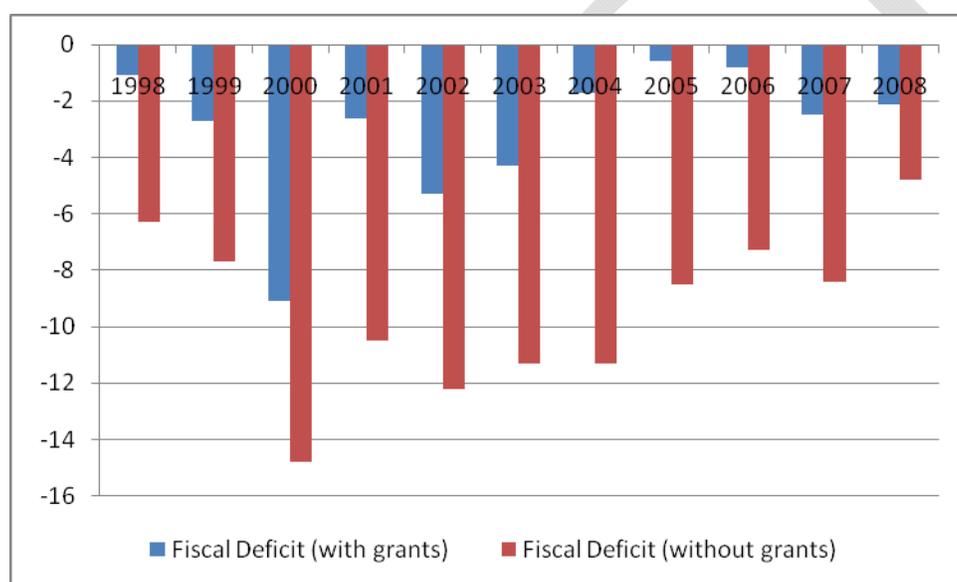
Fig.2: Revenues, Expenditures and Grants (percent of GDP)



² These Statistics are from Kasekende, et.al, 2004 and UBOS, 2009

The contrast between revenue and expenditure highlights a serious financing problem for the country that necessitates the use of external financing to cover the budget deficit. For example whereas in 2007/08, the share of total government expenditure to GDP was 17.1 per cent, that of revenue to GDP was 13.5 per cent. Consequently, the fiscal deficit including grants is estimated at 3.5 per cent of GDP in 2008/09. But this fiscal deficit is actually an improvement from about 6.5 per cent in 2001/02 due mainly to the various debt forgiveness initiatives and the commitment of the government to finance most of the budget by domestic revenues.

Fig. 3: Budget deficit including and excluding grants (per cent of GDP)



2.3 Domestic borrowing and debt

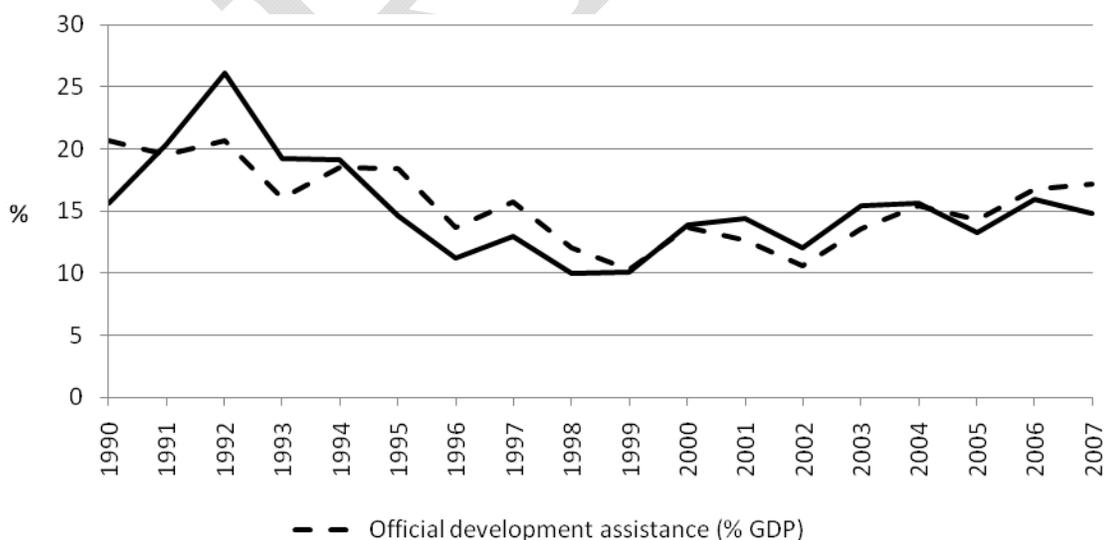
After the diminishing concerns over external debt due to the various debt forgiveness initiatives including HIPC and MDRI, concern has been rising about the level of domestic debt which according to the Bank of Uganda, had increased to U Shs 2 trillion by June 2007 from about 320 billion in June 2000. The main culprit for this high domestic debt is its use as an instrument for providing resources for monetary policy management to maintain macroeconomic stability, but which has put a high fiscal cost on the treasury. In response, the government has come up with specific debt sustainability benchmarks that will guide its undertaking domestic borrowing, some of which include limiting both domestic debt stock to GDP and domestic interest cost to total domestic revenue (excluding grants) ratios to less than 15 per cent, domestic debt stock to total private credit at less than 100

per cent, and to make sure the borrowing does not jeopardise the country's efforts at improving its sovereign rating to above the B⁺ that the country is now enjoying.

2.4 External borrowing and debt

On external financing, the government has been trying to limit the share of the budget financed by donors, either through grants or procurement of more debt. Consequently in spite of the increase in the overall budget, the per cent of the budget financed by external resources has decreased from about 72 per cent in 1999 to 33 per cent in 2008. The percentage of debt to GDP has consistently declined from a high of about 63.7 per cent in 2003 to an estimated 12.5 per cent in 2008. The government at the end of the year 2007 put in place a new debt strategy that broadens the one that had been in operation since 1995, by including domestic arrears and public domestic borrowing. Under the external debt strategy, the government has decided to give grants priority over loans, and to strictly adhere to concessional terms, limit borrowing to only five priority areas especially in infrastructure, and to set a 5-year borrowing cap. In addition the government decided that debt is aligned with absorptive capacity and availability of government counter-funding. Since the government has a Medium Term Expenditure Frame Work (MTEF), the intention is to make sure that all the borrowing is within the MTEF limits and that there is enough absorption capacity for the resources.

Figure 4: Aid (per cent of GDP) and Net official development assistance, 1990-2007 (per cent of GNI)

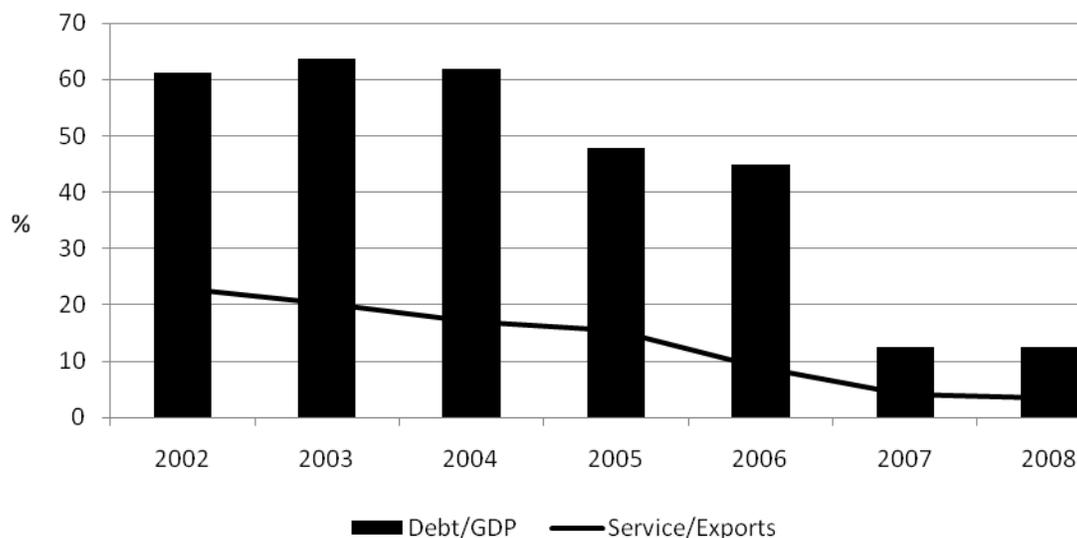


Source: World Development Indicators, World Bank, 2008

But as noted above, due to a number of debt forgiveness initiatives, the country's debt obligations have recently gone down. Consequently, the percentage of Debt to

GDP has reduced from about 61 per cent in 2002 to about 12 per cent in 2008 (Fig. 5)

Figure 5: Stock of Total External Debt (percentage of GDP) and Debt Service (percentage of Exports of Goods and Services)



Source: World Development Indicators, 2008

2.5 Current account and the external debt

In 2008, capital inflows, largely of foreign direct investment (and loans), more than financed the current account deficit, entailing a surplus in the balance of payment, and raising the stock of international reserves to about 5 months of imports of goods and services by the end of 2008. Foreign Direct Investment is estimated to have increased from US\$432.6 million (2.5 per cent of GDP) in 2007 to US\$536.6 million in 2008 (2.7 per cent).

Remittances have also contributed to a good capital account balance. Remittances have increased in absolute terms over time, as share of GDP remittances were about 3.4 per cent of GDP in 2007/08 (excluding informal remittances), nearly half the share of exports of goods to GDP.

2.6 Uganda and Foreign aid

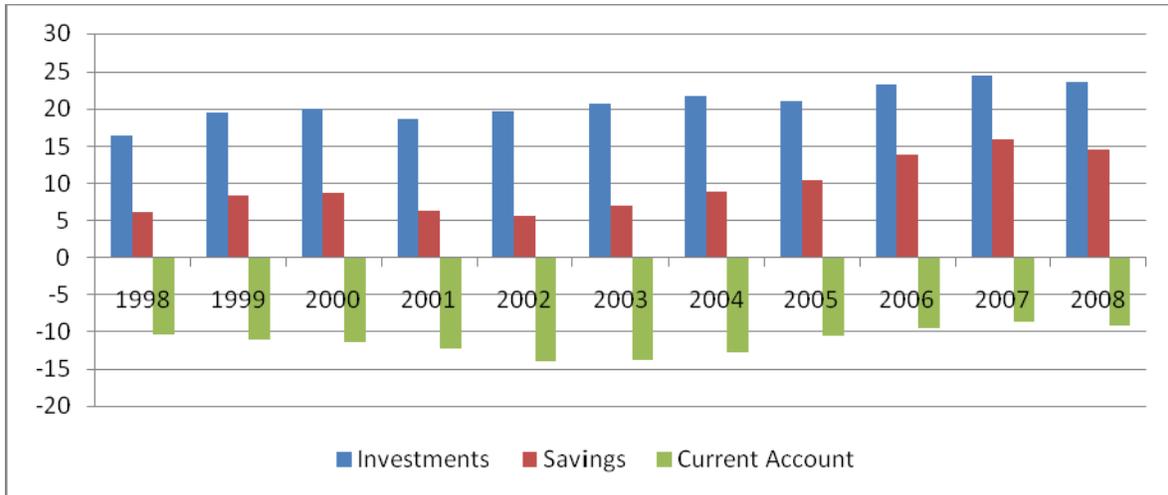
Uganda receives most of its external Official Development Assistance (ODA) from multilateral organisations (80.4 per cent of total debt owed in 2006/07) with the three main donors owed, being the International Development Agency (IDA) of the World Bank (50.4 per cent of total debt), the African Development Bank (8.4 per cent), and the European Investment Bank (7.6 per cent), in that order. “Non-traditional Donors” that are becoming important as sources of ODA for Uganda include India (1.7 per cent of total debt in 2006/07) and China (1.3 per cent), although the country still owes some other countries from long overdue debt obligation from time ago, like Tanzania, Libya and Kuwait. Debt obligations to the

Paris Club have sharply declined since the country was forgiven most of the debt owed to the club in 2000 under the extended HIPC. In addition to the traditional donors, the main sources of ODA, the country receives a large amount of transfers from other donors like the NGOs, and other project funds that often are hard for the BOU to follow and quantify. To go around this, the country recently established the so-called Basket Fund in which all the donors channel their donations in order to be sure that they are covered by MTEF and that they do not destabilise the macro-economy of the country.

3 Savings Performance

Uganda like 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 percent of GDP, compared with 26.0% in South Asia, 24.026.0% in Latin America and the Caribbean, and nearly 42 percent in East Asia and Pacific countries (World Bank, 2007a). The savings rate for Uganda has broadly evolved over the years in the following pattern. From 1984 to 1994 due to the uncertain political and economic environment, it increased steadily from 6.5% to 14.3% of GDP (World Bank, 2007a). It then experienced much higher volatility reaching its lowest rate (nearly 0.2%) in 1994. With the implementation of the economic recovery programs and structural adjustment programs, there has been a tentative recovery, yet the rate has remained low, stagnating below 10% in for the last decade (see Fig 6). In addition to savings rates, stability over time is crucial for smooth and predictable investment, and Uganda again fares worse than other developing SSA countries in this area. A major reason for this is the volatility of the sources of income, which is higher in Africa than in other developing regions, due mainly to exogenous shocks. The standard deviation for gross national savings as a share of GDP from 1980 to 2009 was 2.4% for Uganda compared to 6.6% for the East Asian Tigers and 6.0% for Latin America and the Caribbean (Schmidt-Hebbel et al.,1994).

Fig. 6: Total Savings, Investments and the Current Account



The capacity to save is mainly determined by income level, rate of income growth and the dependency ratio, i.e. the ratio of population under 16 or above 60 years old to that of the working-age population (Loayza et al., 2000). Willingness to save, meanwhile, is believed to depend on the ease of access to savings instruments, the attractiveness of such instruments and the prevailing economic conditions (Wright, 1999). Gross savings rates provide a useful insight into the general picture of savings in a national economy. They are not, however, necessarily reliable indicators of the domestic resources available for investment. Fig.7 provides a glimpse of the composition of private and public savings and the corresponding investment levels. Clearly, while private savings have been on the increase, they are way below the required investments. This is also coupled with the fiscal deficits run by the country.

Fig. 7a: Private and Public Savings

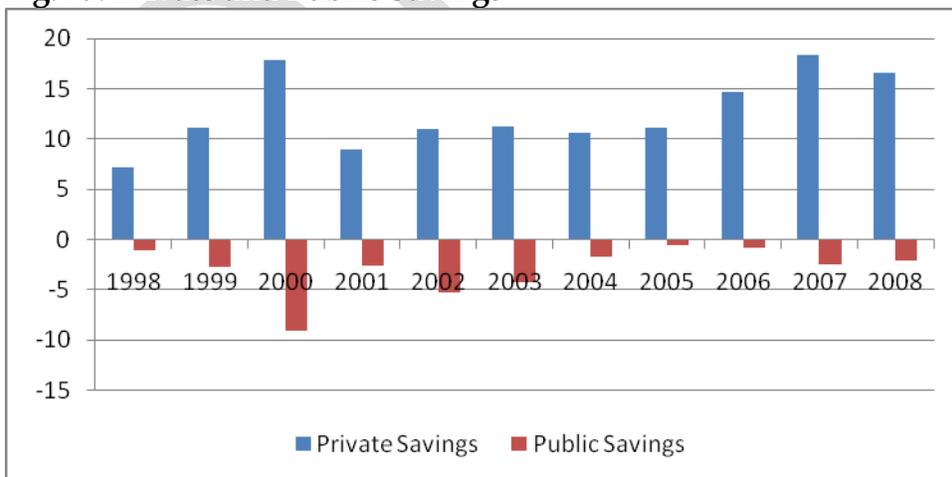
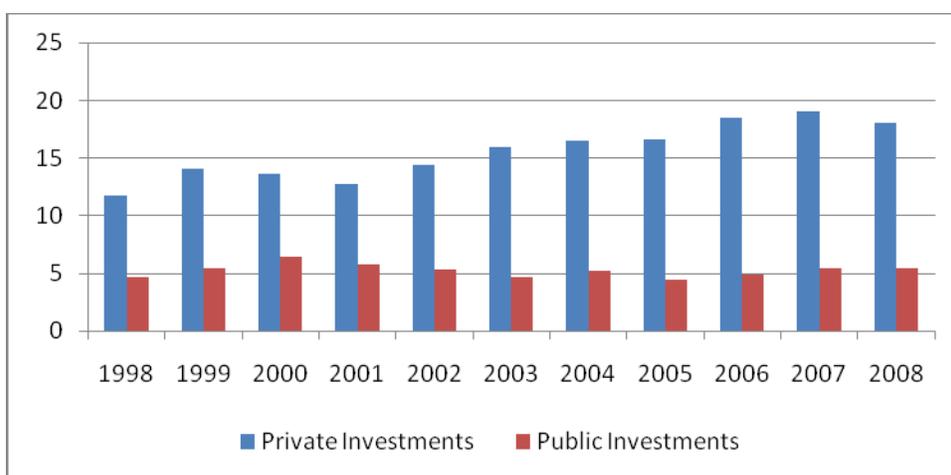


Fig. 7b: Private and Public Investments



Considering that savings can exist in many different forms, the nature of savings instruments has a large impact on the possibilities for transforming savings into productive investments. To understand the nature of savings and their relation to investment, it is necessary to look into the details of saving options and choices at the household and firm levels.

3.1 Household Savings

Saving as a precaution implies that even at low disposable income levels and in the absence of attractive savings instruments, poor households need to save a substantial part of their income. This kind of precautionary saving is the main motivation for household saving in Uganda. Savings instruments for households fall into non-financial savings, informal financial savings, formal financial savings and semi-formal financial savings. The composition of household savings portfolio determines availability of funds for investment, and is therefore relevant to a country's development. Generally, household savings consist mainly of physical assets and some financial savings held in the informal financial sector. Thus, only a small part is available for productive investment. Understanding why and how households save, especially poorer households, can help to identify policies that increase the amount of resources available for development. Households, especially in rural areas, rely on volatile income sources. In the absence of accessible credit and insurance services, drawing on saved assets is a necessary strategy for households to smooth their consumption patterns (Deaton, 1990; Dercon, 2002).

3.2 Non-financial Savings

Generally, households often hold considerable diverse portfolios of non-financial assets, such as livestock, stocks of goods for trading, grain and construction materials that are acquired as stores of wealth, and are often bought or sold in such a way as to smooth consumption patterns. While the evidence is limited, studies suggest that non-financial assets represent around 80 per cent of all household assets in rural areas (Aryeetey and Udry, 2000). The accumulation of non-financial

assets as saving instruments, however, can reflect rational portfolio decision in a context of high risk, uncertain financial environment and lack of access to adequate financial instruments. In this way, an improvement in access, adequacy and reliability on the part of the financial sector could trigger an increase in savings held in a financial form through substitution from non-financial to financial saving instruments.

3.3 Informal financial savings

This is another form of savings that offers a wide range of saving instruments, from simple deposit collection to large, self-organized saving groups and saving pools. Mostly, savings tend to be made in small but frequent deposits that correspond to the needs of households and small businesses. Problems of access and reliability are limited in comparison to the formal financial sector as informal financial institutions operate in geographically and socially confined community settings (Nissanke and Aryeetey, 2006). In contrast to the formal financial sector, it is rare for informal sector savings to accrue interest. In Uganda, there is a recent drive to encourage people joining Savings and Credit Organisations commonly referred to as SACCOS. Resources mobilized through saving in the informal sector are generally not used for further investment and therefore tend not to generate any income. In most cases therefore, depositors are required to pay for the saving service. The fact that poorer households save despite receiving what are in effect negative interests is testimony to the importance of saving services for poorer households and to the willingness of such households to save. Households in Africa tend to combine a number of saving instruments with different institutions, offering different deposit and withdrawal conditions. This helps them spread default risk and meet their changing need for financial resources (Wright, 1999).

3.4 Formal financial savings

The savings held in the Uganda's formal financial sector generally represent a small proportion of household assets. This reflects the difficulties in access to formal saving instruments and, more importantly, the lack of trust in formal financial institutions, as well as the inadequacy of formal saving instruments to fulfill poorer households of savings needs. In practice, banks are the principal type of formal financial institutions engaging in savings mobilization under the supervision of Bank of Uganda the country's central bank. Physical distance from banking institutions is not the only limiting factor to the growth of formal financial savings. High minimum deposit and balance requirements, the time that it takes to make transactions and the administrative work involved also discourage depositors. Furthermore, the reluctance of banks to provide credit to poorer households and small businesses lessens the incentive to save in the formal sector (Wright, 1999).

There are some encouraging signs, however, that technology may be able to overcome some of the remoteness and processing-cost barriers to providing

services to poor and rural areas. Mobile phone banking enables banks to provide basic financial services to poor people, including in rural areas. Though it is only a recent development, mobile phone banking is already reaching thousands of customers in Uganda.

3.5 Semi-formal financial savings

The semi-formal financial sector specialized in providing financial services to households and small businesses that do not have access to formal financial institutions. This sector is made up of institutions that, while legally registered, are not regulated as banks. While this semi-formal sector could become an important factor in savings mobilization for households, its coverage is at present too limited to respond effectively to the financial needs of many households in Uganda. The semi-formal sector, however, holds great potential in terms of improved savings mobilization. Indeed, if semi-formal institutions succeed in offering safe and reasonably liquid savings instruments that generate positive returns for many households, there could be a substantial increase in financial savings available for profitable investments due to reallocation from both nonfinancial assets and financial assets currently held in the informal sector.

In sum, the choice of saving instrument reflects issues of access, reliability and relevance of available saving instruments to meeting households saving needs. The financial requirements of households therefore call for safe saving instruments that allow small transactions at frequent intervals. The very high proportion of non-financial assets in household savings portfolios suggests that the financial sector is currently not adequately fulfilling these needs.

4 Financial Markets and Intermediation

Financial intermediation provides the crucial link between savings and investment. A well-functioning financial system should be able to mobilize resources effectively and allocate them to the most productive investment opportunities. Without effective financial intermediation, the incentive to hold financial savings is depressed and investment tends to concentrate in the sectors in which the savings take place, which may not be the most productive. As a result, there are fewer resources mobilized and these are allocated to less productive investments.

Uganda has made remarkable progress in establishing the basis for a sound and profitable financial system, but financial intermediation remains low (Table 1). The low financial intermediation partly reflects past problems, including a weak supervisory framework, bank failures, and state ownership that led to a significant loss of confidence. The health of the banking system improved substantially following the closure of several distressed banks and the privatization of the UCBL in September 2002. However, the balance sheets of banks still reflect their preference for liquid and low-risk assets related to a number of structural

impediments (e.g., contract enforcement problems, poor credit discipline and information sharing, and limited use of collateral). Interest spreads, also high by regional standards, are attributed to higher operating cost, high credit risk, and weak competition. Despite the growing number of MFIs, gaps remain in the provision of financial services for agriculture, SMEs, and infrastructure.

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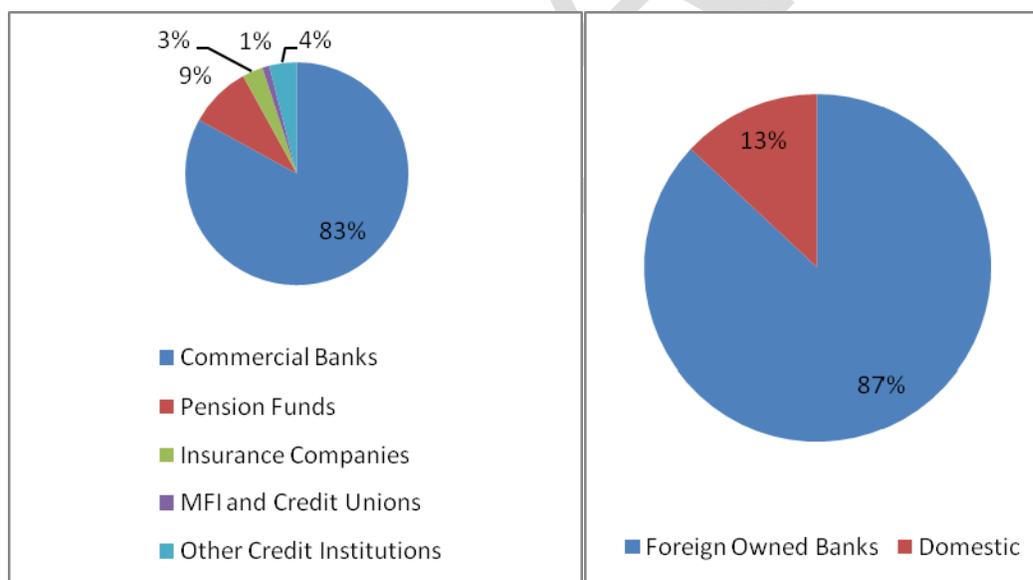
Table 1: Financial Intermediation across Countries

	Private Credit/ GDP	Bank Deposits/ GDP	Loan/ Deposit Ratio	Overhead Costs/ total earnings
Uganda	7	19.6	42.1	7.9
Tanzania	6.8	22.2	40.9	7
Kenya	22.6	42.9	60.1	6.1
SSA	19.1	31.3	74.2	6.1
LICs	15.1	30.7	70	5.9

4.1 Formal Financial Intermediaries

The Bank of Uganda (BoU) is the nations Central Bank, responsible for the licensing, super-vision and regulation of the banking system. The mission of the BoU is to foster price stability and a sound financial system. The financial system consists of the Bank and Non-Bank Financial Sector. However, Uganda has a financial system dominated by the banking sector (Figure 8).

Fig. 8: Dominance and Ownership of Commercial Banks.



The financial institutions currently operating in Uganda can be categorized into six groups, which include Central Bank, Commercial Banks, Credit institutions, Insurance companies, Development Banks and Foreign Exchange Bureaus. In 2008, this sector had 17 registered commercial banks and 2 development banks and 7 credit institutions, 2 development banks, 16 insurance companies, 28 insurance brokers, 96 micro finance institutions and 70 operational foreign exchange bureaus.

The banking sector is also characterized by a high degree of foreign ownership. The largest bank, the successor to the state-owned Uganda Commercial Bank, was purchased by a South African bank in 2002. Three other foreign banks account for approximately 75% of Uganda's banking sector assets. A deposit insurance fund with contributions from the central bank and commercial banks has recently been created, though its soundness is largely untested to date.

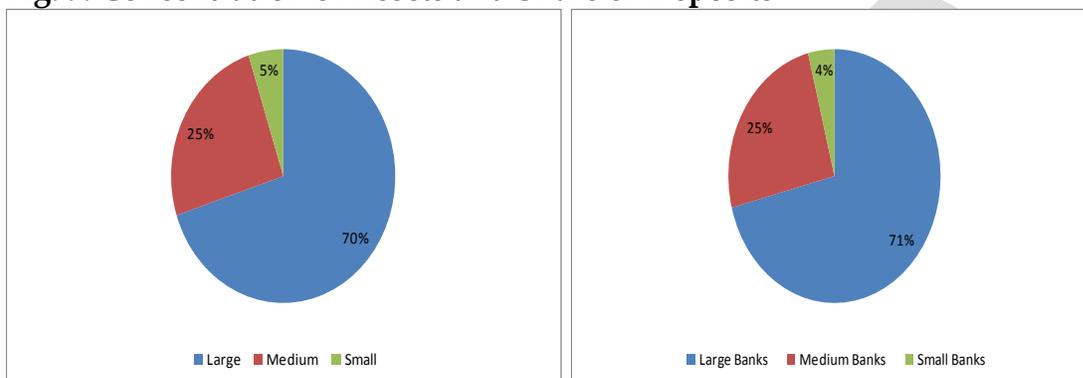
In 2005, there were also 7 savings and loan institutions and over 100 micro-finance institutions. Despite their large number, micro-finance institutions accounted for only 1% of the financial sector, while other nonbank financial institutions accounted for 7% (2005). The insurance sector remains a small part of the financial system. There were 15 licensed insurance companies in 2006, all under the supervision of the Uganda Insurance Commission (UIC), a regulatory and supervisory authority for the insurance industry in Uganda. Some recent developments include the planned privatization of the National Insurance Company and the creation by the Uganda Insurers Association of a reinsurance company.

With lack of definite policy directions and regime change, Uganda's financial system had for a long time been characterized by several distortions in terms statutory interest rate ceilings, directed credit, accommodation of government borrowing, exchange controls and informal modes of intermediation. The formal financial sector was also concentrated by two domestic commercial banks with excessively large branch networks and high overhead costs. In addition, securities, equities and inter-bank markets were either non-existent or operating inefficiently. Other constraints included deficiencies in the management, regulation and supervision of financial institutions and a low level of central bank autonomy. The economy also suffered political and social upheavals, as well as high inflation rates. The combination of these factors created an uncompetitive and inefficient financial system, and impeded monetary control and policy conducive for profitable trade and economic growth.

The limitations of the financial sector in mobilizing and efficiently allocating domestic savings to most profitable investment opportunities in Uganda is a major concern. During the adjustment period, monetary policy has been successful in containing inflation. Reforms in the financial system to enhance financial intermediation, however, have been one of key weakness in the adjustment period. Uganda's economy is significantly un-monetized, with a large ratio of currency in circulation to deposits. Rural financial markets remain effectively undeveloped and because of the high costs of intermediation, interest rate spreads are high. Moreover, term lending continues to be difficult and inadequate to finance investment in agriculture.

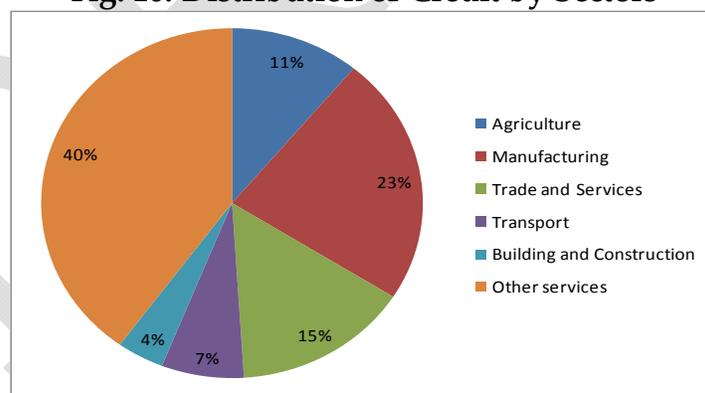
Greater financial depth (that is, higher ratios of total financial assets to national income or output) is associated with higher levels of productivity and thus income per capita. Second, that the latter are also associated with a more advanced financial structure, that is: the move from banks towards non-bank financial intermediaries, and from both of these towards stock markets. Figure 9 demonstrates that financial intermediation in Uganda is still weak with 70 percent of financial assets only concentrated in the largest four banks. The four largest banks also take a share of 71 percent of the total deposits.

Fig. 9: Concentration of Assets and Share of Deposits



In addition, the distribution of credit remains unfavorably skewed in line with the sector composition of GDP. The bulk of lending is mainly targeted to the services sector. However, agriculture which employs more than 70 percent of the population only receives 11 percent owing to its risky nature and banks being averse to lending the sector.

Fig. 10: Distribution of Credit by Sectors



Most of the banks are also largely involved in short-term lending due to the lack of long-term financing. This is partly related to the underdeveloped and not well regulated pension sector which can partly provide long-term financing. Partly due to the high interest rates offered on T-bills, Banks have resorted to buying treasury bills which are considered to be risk free. This to an extent also has tended to crowd out the available financing for the private sector.

Fig. 11: Maturity of Bank Assets

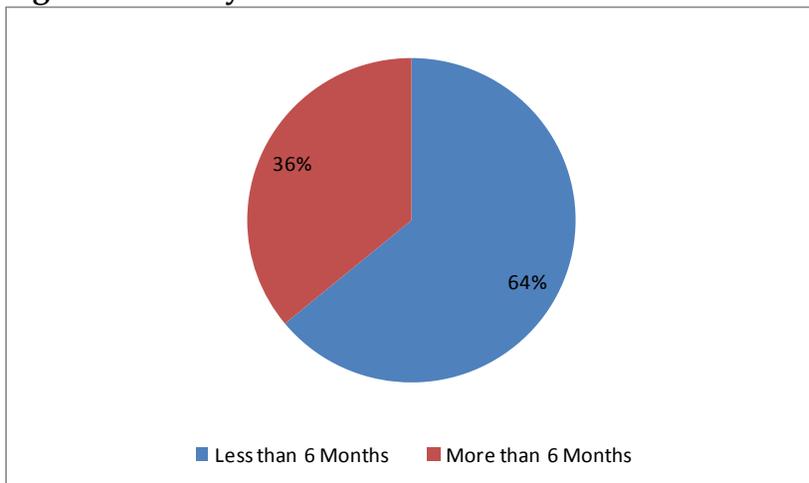
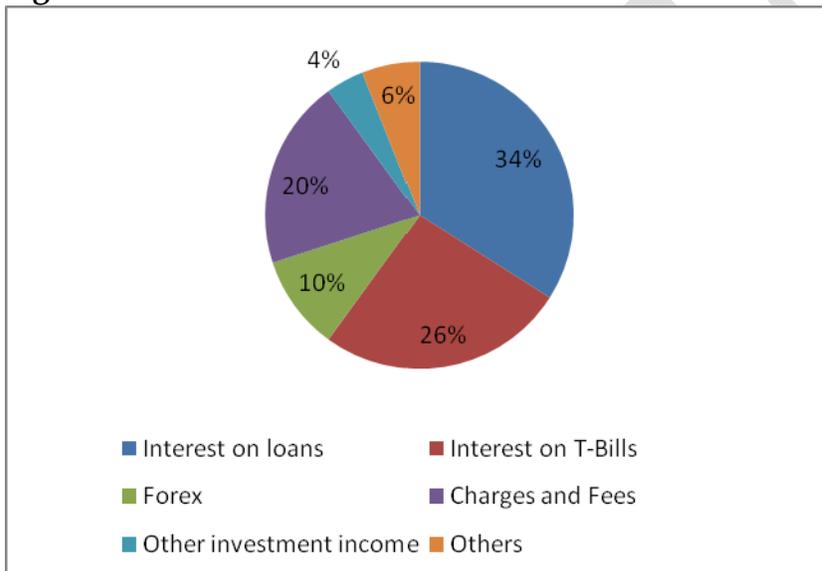


Fig. 12: Income Distribution of Banks



Interest rate spreads are high by regional standards and are mainly explained by overhead costs, credit risk, and weak competition. Interest rate spreads the difference between the weighted average lending rate and the weighted average deposit rates are about 20 percentage points at present. Operating costs explain about 50 percent of the spread, and profits are the second largest component with 30 percent of the overall spread. Ugandan banks have higher overhead costs than comparable banks in Kenya, partly because they do more outreach and have recently invested in physical infrastructure, such as branches and ATMs.

Cross-country comparisons show that smaller banks have higher overhead costs because they find it difficult to exploit economies of scale and scope. This is confirmed by a significant positive correlation between the share of deposits and

loans below U Sh 3 million in total deposits and loans and overhead costs, as well as the relatively low ratio of loan and deposit volume per branch in Uganda. While the 2% points in the spread explained by loan loss provisions can be directly attributed to this high credit risk, the high overhead costs and the high profit margin can also be partly explained by high credit risk, as banks incur high evaluation, monitoring, and enforcement costs. The high interest spread and profit margin may also reflect weak competition. A lack of sharing of credit information on borrowers, widespread fraud, dysfunctional land and company registries, and deficiencies in the insolvency laws and their administration increase credit risks for banks and reduce competitive pressures.

Uganda has made some progress in expanding outreach and access of financial services to its population. Branches of financial institutions of tiers 1 to 3 exist in 51 districts in the country, with a population per branch of about 87 thousand. The FSAP Update estimated the total number of deposit accounts held in financial institutions (tiers 1 through 4) to be just over 1.7 million, or about 35 percent of households. The inclusion of 80 entities from tier 4 (together accounting for a large majority of the tier 4 market) adds only about 150 thousand deposit accounts and 85 thousand loans. The new Micro-Finance Deposit-Taking Institutions Act, 2003 and nurturing the transformation of MFIs into tier 3 institutions should further encourage rural financial intermediation.

Gaps remain, however, in the provision of financial services to rural areas, and in financing SMEs, agriculture and infrastructure. Although the coverage of deposit accounts as a proportion of the total number of households is relatively large as reported above, the use of deposit and payment services could be substantially expanded. Moreover, only about 11 percent of bank credit is reported as being allocated to agriculture, a more acute level of credit rationing to the sector than in most other countries, given the large contribution of agriculture to GDP.

The development of stock markets is necessary to achieve full efficiency of capital allocation if the government is to liberalize the financial system because if the financial market is composed of banks only, the market will fail to achieve efficient allocation of capital because of the shortcoming of debt finance in the presence of asymmetric information (Guglielmo et al., 2004). Banks finance only well-established and safe borrowers but, stock markets can finance risky, productive and innovative investment projects. Thus, the primary benefit of a stock market is that it constitutes a liquid trading and price determining mechanism for a diverse range of financial instruments. This allows risk spreading by capital raisers and investors and matching of the maturity preferences of capital raisers and investors both in the short-term and long term. This in turn stimulates investment and lowers the cost of capital, contributing in the long term to economic growth.

The Uganda Stock Exchange (USE) has served a useful purpose for the privatization strategy of the government, but has not yet raised equity finance for

domestic enterprises or provided a viable trading platform. Trading in the six listed issues is sporadic and negligible measured both in real terms and relative to market capitalization. The costs of issuance on the USE are too high in light of the small number of investors reached. The Capital Markets Authority (CMA), the securities regulator, does not distinguish between types of securities market investors. The USE may be more effective if it is focused on a lower disclosure standard for new issues combined with a greater reliance on collective investment schemes to reach the broader public while targeting the regional market of sophisticated and international investors.

4.2 Informal financial sector

The informal financial sector refers to all institutions and transactions occurring outside the country's official financial services system. Studies suggest that, in Africa, it is larger than the formal financial sector in terms of influence, coverage and even value of transactions (Nissanke and Aryeetey, 2006). It is estimated that at most only 20 per cent of African households have access to formal finance (Honohan and Beck, 2007).

Institutions offering financial services in the informal sector range from large savings groups to individual moneylenders. The range of services offered is similarly vast, with a large array of different savings collection instruments and lending arrangements, including non-commercial financial transactions between friends and relatives. Some of the most prevalent institutions in this sector are deposit collectors, moneylenders and credit associations. There are also micro-insurance groups that pool small contributions from members and make funds available for particular events such as weddings or funerals (Wright, 1999; Dercon, 2002). Institutions in the informal financial sector typically focus either on deposit collection or on loan extension. The few institutions that offer both services are generally open only to members. Financial transactions in the informal financial sector are typically small and frequent, reflecting the low level of disposable income and the high liquidity preference of poor households and small businesses. The sector is dynamic, varied and responsive to the needs of the population in terms of financial services. It does not, however, play a significant role in financial intermediation, despite its strong capacity for savings mobilization. It appears that the risk management strategies employed by informal financial institutions, which allow them to operate in the lower end of the financial market, also constrain their expansion.

Informal financial institutions rely on personal relations and repeated transactions as principal risk-reducing strategies. The social pressure exerted by the community in which transactions take place is also of key importance in reducing the likelihood of fraud or default (Nissanke and Aryeetey, 2006). This reliance on personal relations and social pressure constrains the expansion of informal financial institutions beyond the community level. With the advent of new

information and communication technologies (ICTs), however, the transaction costs that limit the scale of operations of these institutions should be reduced to a minimum.

5 Public Sector Revenue Mobilization and Taxation Policy in Uganda

The amount and efficiency of government spending is an essential part of making domestic resources the engine for economic development. Public sector resources have a distinct and complementary role to play vis-a-vis private savings. While a distinction can be made between public expenditure, which covers recurrent costs, and public savings, which fund longer-term investments, the needs that both address are immense in economic development. Public expenditure is essential to human capital development through its funding of essential public services such as education and health care. Public investment, on the other hand, can provide the resources for infrastructure that is indispensable for the private sector to thrive. To finance public investments, government raises revenues through taxation. The level of taxes to GDP remain very low which is largely characterized by a narrow tax base and inefficient tax system. In an attempt to improve tax collection several tax reforms have been undertaken.

5.1 Policy Reforms to Increase Tax Revenues

The Tax Reforms in Uganda that have been undertaken are frequently distinguished as direct and indirect. Uganda relies on both direct and indirect taxes. Under direct taxes include PAYE, withholding tax and corporate tax; and indirect taxes include excise duties and VAT. Non-tax revenues comprise collections like dividends from BOU, collections by ministries and foreign missions, collections from fees and licenses.

Uganda heavily relies on indirect taxes but the share of direct taxes has been growing. Uganda's tax reform goals have been fourfold: broaden tax base; increase efficiency of collection; create incentives for the private sector; and ensure equity of taxation. The tax reforms undertaken were comprehensive and intended to encompass most of the important revenue sources and involved the adoption of new tax codes. The reforms were directed at rationalizing the tax structure and tax rates, widening the tax base, reducing exemptions, and simplifying procedures. A semi-autonomous URA headed by a Commissioner General was established in 1991 with the view of improving tax administration. The Commissioner General's independence and powers were enhanced in the URA Amendment Act, 2007.

Box 1: Key Tax Policy Reforms

Pay as you Earn: Its brackets was in 1992/93 reduced from five to four and the maximum marginal rate reduced from 50 percent to 40 percent on income exceeding Shs.3.6 million. Other reforms in the income tax was the 1993 increase in the threshold for personal income from Shs 600,000 to Shs 840,000 and the reduction of the income tax brackets from four to three and the top marginal rate from 40 percent to 30 percent for income above shs.4.2 million. There was also an introduction of the New Income Tax Law in December 1997, which was to replace tax holidays with accelerated depreciation allowances. This was to improve the performance of PAYE and non-PAYE component.

Corporation tax or Company tax: Under corporation tax, the major reform was the abolition of all tax exemptions, tax holidays (however this change did not affect investors who had already received tax holidays), suspension of all running investment incentives other than those specifically re-confirmed on fresh application and privatization of state owned enterprises, which brought all corporations into the tax net.

Value Added Tax: This was introduced in 1997 to replace Certificate of Tax Liability (CTL) and sales tax in order to boost non-trade related taxes that were also disappointing in the tax collection effort. The rate was established at 17 percent but was revised in 2005/2006 to 18 percent.

Withholding tax: The major reform in this tax (1997) was the imposition of withholding tax on non-residents who earn income in form of interest, dividends, management fees, and loyalty in Uganda. Effective July 1997, non-residents were required to pay the withholding tax of 15 percent. The rate on supplies and procurement is 6 percent.

Presumptive taxes: This is a tax that is levied on a turnover of less than or equal to 50 million Uganda shillings. It mainly covers small businesses, because any business with a turnover of above 50 million is considered a corporation. These small businesses are associated with inability to keeping proper records, hence unlike corporate taxes. These firms are taxed without adjusting for deductions of expenditures and losses. This tax could have larger implications on low income earners who are largely involved in small scale production.

5.2 Performance of Tax Revenues

Uganda still relies mostly on indirect taxes for its revenue, particularly those inclined to international trade. This dependence on indirect taxes is mainly due to the fact that income taxes are limited by administrative and other constraints. Part of the reason why Uganda's tax base is low is because a large section of the economy is untaxed, especially the informal and the commercial agricultural

sectors, which complicates efforts to widen the tax base and increase domestic revenue.

Table 2: Tax Collection and Tax Base Derived from the SAM

Commodity	Indirect Taxes (millions)	Total consumption (mill)	Taxes Collected (%)	Import duties (millions)	Import Values (millions)	Duties Collected (%)
Maize	282	335,648	0.1	56	61,833	0.1
Rice	...	100,697	0.0	359	24,911	1.4
Other cereals	3,006	442,805	0.7	553	155,347	0.4
Cassava	12,403	610,780	2.0	...	...	...
Irish potato	3,948	214,679	1.8	...	...	...
Sweet potato	4,091	464,289	0.9	...	...	...
Matoke	...	0	...	...	...	...
Oilseeds	...	12,306	0.0	...	...	...
Beans	3,532	167,898	2.1	11	10,243	0.1
Vegetable	17,439	736,810	2.4	...	...	...
Fruits & other tree crops	1,445	35,136	4.1	...	...	...
Flowers	...	...	...	...	...	...
Cotton	...	...	...	...	...	...
Tobacco	...	...	...	...	...	...
Coffee	18,879	693,751	2.7	...	...	...
Tea, cocoa & vanilla	2,135	63,033	3.4	751	6,165	12.2
Cattle & sheep	...	422,060	0.0	...	...	...
Poultry	1,715	66,521	2.6	...	...	...
Other livestock	...	77,164	0.0	115	1,920	6.0
Forestry	24,785	1,317,249	1.9	...	...	...
Fisheries	6,391	579,885	1.1	...	...	...
Mining	4,344	191,415	2.3	9,088	67,917	13.4
Meat processing	36,093	590,925	6.1	360	58,281	0.6
Fish processing	6,323	210,691	3.0	1,222	40,100	3.0
Grain processing	52,925	1,981,416	2.7	31,537	309,941	10.2
Feed stock	22,745	856,446	2.7	10,428	78,904	13.2
Other food processing	...	102,648	0.0	...	...	...
Beverages & tobacco	60,448	1,631,834	3.7	11,082	73,406	15.1
Textiles & clothing	51,880	974,501	5.3	53,374	270,386	19.7
Wood & paper	...	245,492	0.0	19,578	92,753	21.1
Petrol & diesel	27,718	1,193,748	2.3	483,071	600,146	80.5
Fertilizer	63,484	1,628,551	3.9	52,259	668,975	7.8
Other chemicals	8,514	230,892	3.7	18,154	143,348	12.7
Machinery & equipment	9,307	1,287,724	0.7	96,138	533,539	18.0
Furniture	21,491	2,080,779	1.0	252,445	2,162,666	11.7
Other manufacturing	7,646	158,382	4.8	4,527	30,325	14.9
Energy & water	32,139	1,090,077	2.9	...	...	...
Construction	20,781	967,947	2.1	...	...	...
Trade	4,671	4,127,879	0.1	...	...	...
Hotels & catering	5,474	129,729	4.2	...	...	...
Transport	63,909	2,360,061	2.7	...	1,472,148	...
Communications	20,595	911,756	2.3	...	27,937	...
Banking	536	475,845	0.1	...	130,019	...
Real estate	12,452	2,349,390	0.5	...	...	...
Community services	1,855	770,884	0.2	71	246,599	0.0
Other private services	...	2,473	0.0	...	...	...
Research & development	...	24,814	0.0	...	...	...
Public administration	...	1,453,989	0.0	...	...	...
Education	...	369,595	0.0	...	...	...
Health	24,431	467,716	5.2	...	...	...

Using the information from the social accounting matrix, it's revealed that tax collection is still way below relative to its tax base. Focusing on the indirect taxes or consumption taxes which include VAT, Table 2 shows that for most of the commodities, the effective tax rates computed are below the statutory rates. For instance, the statutory VAT is at 18 percent. However, for most commodities the ratio of taxes collected is very low. For all the commodities, it's shown that less than 5 percent of the tax base is collected. This could be a reflection of two problems: first, there could be rampant tax evasion within the tax system. Second, it might be the case that the revenue authority is still too weak to effectively capture the

statutory taxes in the economy. For the case of imports, a different pattern is portrayed where most of the commodities imported indeed meet their statutory tax payments. This background clearly indicated that there is more work to do for the URA to improve on its domestic tax collections. In addition, some imports including fuel are overtaxed and given the importance of this commodity for other sectors like manufacturing and services especially transport, this could impact the economy negatively. Therefore, by improving domestic tax collection this would create room for reduction of taxes on commodities like fuel.

Consequently, the tax burden has for long been falling on only a small section of the population that is either in formal employment or own businesses for which tax assessment is easier. It is estimated that the top 35 highest tax payers in the country alone account for about 50 per cent of all the tax revenue, an indication of how narrow the tax base is in the country. This narrow tax base is also aggravated by the high levels of tax evasion and corruption in the tax administration system. The aggregate outcome of these shortcomings is a low growth in domestic revenue compared to the expenditure needs of the growing Ugandan economy.

Table 3: Percentage Share of Taxes in the Overall Tax Collections, 2002/03-2006/07

	2002/03	2003/04	2004/05	2005/06	2006/07
Central Government Taxes	100.0	100.0	100.0	100.0	100.0
Taxes on Income, Profits ,and Capital Gains	24.7	24.6	27.7	25.7	26.3
PAYE (Payable by individuals)	12.1	11.4	12.3	13.2	13.2
Corporations and Other Enterprises	6.8	7.9	8.8	8.5	8.9
Unallocatable	5.8	5.3	6.6	4.0	4.2
Taxes on property	0.4	0.4	0.3	0.3	0.3
Immovable property	0.4	0.4	0.3	0.3	0.3
Taxes on goods and services	74.9	75.1	72.0	74.0	73.4
General Taxes on goods and Services	37.3	33.3	33.1	33.6	32.6
Imported goods	19.7	19.6	18.2	18.5	18.1
Local goods	8.9	7.3	7.5	8.5	8.7
Local services	8.7	6.5	7.5	6.7	5.8
Excise Taxes	27.6	25.6	24.8	24.4	23.6
Petroleum	16.7	15.4	15.5	16.5	15.3
Other imports	2.8	2.9	2.5	1.1	1.0
Local goods	8.1	7.3	6.8	6.9	7.3
Taxes permission to use goods	2.9	9.1	9.9	14.5	14.2
Motor vehicle taxes	2.2	2.4	2.5	2.7	2.7
Other	0.0	0.0	0.0	0.0	0.0
Custom duties(other imports)	0.7	6.7	7.3	11.7	11.5
Other Taxes	7.1	7.0	4.2	1.6	3.0
Government procurement	0.9	0.7	0.8	0.7	0.7
Other	6.2	6.4	3.5	0.8	2.3

Source: Uganda National Bureau of Statistics (UBOS)

From the basic analysis it's been found that Uganda still lags way behind in its tax collections at the domestic level. For most of the commodities the tax collection effort is not more than 5 per cent relative to the statutory rate of 18 per cent. This results into a situation where the government has to rely a lot on foreign financing. Therefore, there is room for a lot of improvement where URA can be able to increase its tax effort. This could be achieved by targeting commodities that are under-taxed and excluding food items for equity purposes. Increasing domestic tax collection would also result into less overreliance on taxing a few commodities especially fuel which is interlinked with a lot of other sectors and could indeed harm growth in the long-run.

There is also much room for improvement by the URA as far as income tax is concerned. The bulk of this tax is being paid by Kampala residents. In essence, with the abolition of the graduated income tax (which was a poll tax for every Ugandan); the taxes now financing the local governments come just from Kampala and surrounding areas. While there are arguments that this is where richer households and bigger enterprises are located, an effort should be made to expand the tax base beyond Kampala. The introducing the Local Service Tax was a step in that direction.

6 Constraints in Domestic savings Mobilization in Uganda

6.1 Taxation

Low income levels, high unemployment and widespread poverty: Uganda like most other developing countries has a challenge to widen its tax base largely because of the low income levels of its citizens and high unemployment level. The head count level of poverty is currently estimated at 32 percent. The level of unemployment and underemployment is currently estimated at 25 percent. With these statistics, the basis for taxing the citizens does not exist given their limited disposable income. Hence the modern means of raising revenue, such as income taxes and consumer taxes, play a diminished role in economies like Uganda.

Corruption: The level of corruption is still being considered a serious problem within the URA. In a household survey covering the period 1995-97, the URA was rated comparatively corrupt, though less corrupt than the courts and the police, but worse than the health services and local government (Cockcroft and Legoretta 1998). Also, a business survey conducted in 1998, which covered 243 firms, as many as 43 per cent said they were paying bribes to tax officers occasionally or always (Gauthier and Reinikka 2001, p. 22). Revenue corruption manifests itself in the form of smuggling, undervaluation and under-declaration of income and taxable goods and

misclassification of goods. The Customs Department, in particular, has most consistently had difficulties in meeting its targets (Obwona and Muwonge 2002, p. 27). Hence, various forms of revenue fraud could partly be an explanation for the tax share stagnation in recent years.

Structure of Uganda's economy: Uganda's low revenue performance has been attributed to the structure of the economy. Uganda has a significantly large agriculture sector, accounting for 21.4% of GDP in 2007/08. The services and Industry sector contributed 49% and 24% to GDP in 2006/07 respectively. In addition, there has been no shift in the sectoral composition of employment as agriculture remained the major sector with employment in the sector increasing from 66% in 2002/03 to 73% in 2005/06. About 70% of the working population is self-employed in agriculture (UBOS, 2006). The outputs and inputs in the agricultural sector do not attract taxes.

Large informal sector and inadequate tax education: The Uganda National Household Survey (UNHS) 2002/03 showed that Uganda's labor force stood at 9.8 million persons, of whom 2.6 million were in non-agriculture informal sector. Of the 9.8 million persons in the labor force, 3.5 million persons were the working poor. Uganda has a large but declining non-monetary sector of the economy; the sector declined from around 15.1% in 2001/02 to 13.5% of GDP in 2006/07. The non-monetary sector is hard to tax.

Unregulated Small to Medium Enterprises (SMEs) constitutes 75% of all companies in Uganda and employs over 60% of the total workforce. The direct tax these enterprises can appropriately pay is presumptive tax which amounted to only Shs 3.6 billion in 2005/6. Enforcement of this tax has been a challenge due to limited registration of these companies.

Tax evasion and avoidance remains a serious constraint to Uganda's ability to raise resources. While the Uganda Revenue Authority has made significant improvement in administration, this has not particularly been reflected in the improvement in tax collection. This is partly attributed to tax evasion and avoidance.

Tax incentives and holidays: In an effort to attract investors, Uganda instituted several tax incentives and holidays. However, although some effort has been done to streamline and in some cases abolish them, these incentives still remain. They are largely arbitrarily given with no clear expiration and coverage.

6.2 Financial Intermediation

Low Income and High Unemployment: Uganda's low domestic resource mobilization is partly constrained by the low disposable incomes of the population. This is demonstrated by the high poverty levels estimated at 32

percent of the population leaving below the poverty line. While the economy has been growing at an impressive rate, this growth rate has not been translated into jobs and unemployment/underemployment are estimated at 25 percent.

Social and Cultural Norms: The low domestic resource mobilization among the private sector can also be attributed to the social and cultural norms of the population. There are considerable resources being mobilized for social functions like weddings and funerals. These functions tend to be large and extravagant (the average cost of a modest wedding is about US\$20,000 dollars). The wedding receptions are usually as large and requiring resources amounting to would probably never be mobilized by the couple to start a business.

Concentration of Banks: Most banks still remain a preserve of the urban areas. In addition, they are largely dominated by a few banks, few large depositors and loans largely concentrated among the few borrowers. Without spreading banking to the rural areas, the ability to mobilize savings would still remains very limited.

Risk sharing of Banks across sectors: Banks still mainly focus on lending to specific sectors due to their low risk tolerance. Agriculture which is a major sector in Uganda has had problems attracting bank financing given its risky nature.

The maturity structure and range of products is a constraint. Only 12 percent of total loans, 35 percent of loan volume, 17 percent of total deposits, and less than 0.4 percent of time deposits have a maturity of more than one year. Moreover, long-term lending is limited to on-lending of a European Investment Bank (EIB) line of credit, channeled through the Development Finance Department (DFD) of the BOU.

Undeveloped Financial Markets: The market for long-term bonds in Uganda is very shallow, meaning that the supply curve for long-term funds is inelastic; hence no bond interest rate is independent of the demand for funds from bond issuers. In other words, bond issuers are not price-takers and a reliable yield curve is difficult to establish; a yield of 15 percent on a 5-year government bond does not mean private issuers can assume a similar yield. Bond market development requires financial institutions that hold long-term liabilities, because only by holding long-term liabilities can a financial institution invest in long-term assets. Uganda has no such institution except for NSSF (pension monopoly), which invests its long-term assets in short-term assets or real estate.

High Interest rate spreads explained by overhead costs, credit risk, and weak competition remains a major constraint. Interest rate spread the difference between the weighted average lending rate and the weighted average deposit rate—is about 20 percentage points at present. Operating costs explain about 50 percent of the spread, and profits are the second largest component with 30 percent of the overall spread. Low bank interest rates on deposits are 4% whereas the bank

lending rate is on average 24%. With an inflation rate of 8%, this means that real rate on bank deposits is negative. This does not only discourage saving mobilization but greatly discourage the savers leaving the bank in liquidity stress.

7 Opportunities to Enhance Savings Mobilization

7.1 Revenue Policies

Tapping on the informal sector. The URA should make an effort of targeting businesses and commodities that are under-taxed and excluding food items for equity purposes. Increasing domestic tax collection would also result into less overreliance on taxing a few commodities especially fuel which is interlinked with a lot of other sectors and could indeed harm growth in the long-run.

Complete abolition of tax incentives: Given the cost of tax incentives to the ability to collect taxes, the government should make an effort to completely abolish these incentives in its quest for attracting investors.

Implementation of the National Identity Card: To identify the small informal businesses, it would require implementation of the National Identity 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.

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. The tax is highly progressive and can be used to finance especially the local government development programs.

Simplification of the Tax System: It is generally accepted that Uganda's taxpayers do not understand the tax system. The number of tax disputes between URA and taxpayers handled by the TAT are large. These problems leave no doubt that despite the quite comprehensive changes in the tax structure in recent years; the tax system is still complicated and non-transparent. There should be more renewed efforts aimed at simplifying the tax system and educating the taxpayers. Civil Society Organizations like UDN should supplement the current efforts by URA in simplifying the tax system and educating the taxpayers. Civil society groups should produce a citizen's revenue guide to broaden understanding of the country's tax systems and to inform tax debates.

Simplification of tax administration: Occasionally, crude methods of revenue collection have been employed to enforce compliance in revenue collection. Simplifying taxation approaches should include markedly reducing tax exemptions, deductions and privileges that cause losses to the treasury as well as corruption tendencies. Assessors should not have wide discretionary powers to interpret tax laws, for instance, to allow or disallow expenses or charges, or to exempt items from import duties.

Key Issues and Recommendations for Increasing Taxes	
<i>1. Short-term Measures</i>	
Problem	Recommendations
<ul style="list-style-type: none"> • Ineffective 1 % turnover tax for businesses with turnover less than 50 million • Over-reliance on import taxes through high rates which leads to under declaration at customs points. • Overly cumbersome procedures to register as VAT tax payer. • Tax incentives and credits which largely benefit the large firms. 	<ul style="list-style-type: none"> • Reduce turnover tax rate to less than 1 % to encourage more small firms into tax net. • Broaden the tax base by introducing new tax handles and reduce taxes on overly taxed import goods. • Simplify the registration procedures for registering as VAT tax payer especially for small businesses. • Abolish all tax incentives and credits
<i>2. Medium-term Measures</i>	
<ul style="list-style-type: none"> • Ineffective property tax law. • Large unregistered businesses • Implement a national identity card system. • Large informal commercial farmers. • Poor record keeping especially for small businesses. • Rampant Corruption 	<ul style="list-style-type: none"> • Fully implementing a property tax and harmonizing it with the rental tax. This would require a well functioning land registration board to establish ownership. • Introduce presumptive taxes especially for organizations that are not registered and do not keep proper book records. • Implementation of a national identity card system would enhance the ability of URA to identify especially informal businesses • Investigate mechanisms to bring commercial farmers into the tax net. • Provision of training to small businesses on how to keep records for tax purposes. • Introducing new credible punitive measures including confiscation of property not commensurate with income of a revenue officer.

7.2 Financial Intermediation

Strengthening and expanding financial institutions and markets. This should involve supporting and/or encouraging banks to extend financial services to rural areas. The government should also continue to mobilise private savings through creation of SACCOs.

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.

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

Development of an Agricultural Bank to provide financing to the agricultural sector. Agriculture being a risky sector, the government could consider opening a bank largely targeted to the 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.

Strengthen the Credit Reference Bureau (CRB). This will provide timely and accurate information on borrower's debt profile and repayment history to enable lenders make informed decisions on the allocation of credit. Better information would enhance competition for sound borrowers, while giving borrowers an incentive to service their loans in order to maintain good credit records.

Modernize the land and company registries as a means of hastening the process of extending credit. The process of computerizing the land registry started in 2007 with Kampala, Wakiso, and Mpigi districts, before it is rolled out to the entire country.

Update the insolvency legislation. Effective insolvency systems play an important role in fostering financial stability, financial sector development, and efficient allocation of resources, thus contributing to economic growth.

Key Issues and Recommendations for Improving Financial Intermediation	
<i>3. Short-term Measures</i>	
Problem	Recommendations
<ul style="list-style-type: none"> • Ineffective land registration system limiting enforcement of contracts. • Limited access of financial services to the rural sector. 	<ul style="list-style-type: none"> • Accelerate rehabilitation of the land and companies registry. • License tier 3 institutions in compliance with the principles set out in the MDI Act. • Focus government capacity-building efforts on regulated institutions and high performing tier 4 entities. • Expand access to the payment system to tier 2 and 3 institutions.
<i>4. Medium-term Measures</i>	
<ul style="list-style-type: none"> • Limited availability of long-term financing • Limited availability of financial products. 	<ul style="list-style-type: none"> • Restructure governance of NSSF, including by hiring independent professional board members. • As soon as the regulatory authority for pensions is established and functional, rescind the monopoly status of the NSSF. • Any future donor support to term financing, such as the EIB facility to be provided at market rates. • Expanding the available financial products including wider use of mortgage financing for the housing market and use of sovereign and municipal bonds to finance development expenditures.

8 Conclusion

This paper discusses possible approaches for improving the mobilization of domestic resources for development in Uganda focusing on the interrelationship between domestic saving, government revenue, capital accumulation and economic growth. In particular, it highlights the possibility of creating a virtuous cycle of higher domestic saving and investment rates, and higher trend growth.

The paper highlights the weaknesses in mobilizing resources emanating from the public sector. It's found that the ability for the government to raise revenues is partly hampered by several factors including: (i) large informal sector, (ii) dominance of the agriculture sector, (iii) tax evasion and avoidance, (iv) weak tax administration. However, the paper also identifies opportunities which the government can pursue to increase its revenue base including the abolition of tax incentives, introducing and enforcing new taxes, and simplifying the tax system

On financial intermediation, Uganda still lag behind other countries and more should be done for this sector to be a conduit of savings and investments. The key constraints identified include: (i) Concentration of Banks in urban areas, (ii) low

risk sharing of Banks across sectors, (iii) short maturity structure of bank assets, (iv) limited range of financial instruments, and high interest rate spreads explained by overhead costs, credit risk, and weak competition remains a major constraint. The key opportunities in this sector include: (i) strengthening and expanding financial institutions to rural area, (ii) increasing availability of development finance for investors in priority sectors of the economy (iii) encourage opening of alternative sources of long term capital and (iv) strengthen the Credit Reference Bureau.

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