AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

UGANDA

Driving Uganda’s Transformation

The Reform of the Global Financial Architecture

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ACRONYMS AND ABBREVIATIONS

AEO	African Economic Outlook
AfDB	African Development Bank
CFR	Country Focus Report
COVID-19	Coronavirus Disease 2019
ETD	Economic Transformation Database
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
NDCs	Nationally Determined Contributions
SDGs	Sustainable Development Goals
SDR	Special Drawing Rights
SOFR	Secured Overnight Financing Rates
UGX	Uganda Shilling
USD	United States Dollar

EXECUTIVE SUMMARY

Macroeconomic Performance and Outlook

- Uganda's real GDP growth slowed in 2023 to 4.6 percent, held back by contractions in food crop production and public administration, as well as flat manufacturing output. Price pressures continued to moderate in 2023, with an average inflation rate of 5.5 percent. The economy is expected to expand 6.0 percent in 2024 and 7.0 percent in 2025, as oil companies continue to ramp up investments. Higher growth and investment will sustain high levels of imports that will keep the current account deficit elevated over the medium term.
- The government remains committed to fiscal consolidation driven by cuts in current and investment spending, more than increased revenue mobilization. The budget deficit narrowed for two consecutive years, to 5.1 percent of GDP in 2022/2023, and is estimated to decline to 4.2 percent of GDP in 2023/2024.
- The economy stands to gain from tailwinds, as external risks to the growth outlook appear to be subsiding. As global prices continue to stabilize, global financial conditions will moderate and help further spur investment and boost growth in Uganda. Domestic headwinds stem from delays in oil-to-market, lower tax revenue mobilization, and low efficiency in public investments.
- To accelerate its structural transformation, Uganda will need to continue investing in public infrastructure and facilitate business development through improvements in the investment climate, spurring job creation in higher productivity sectors, and broadening the domestic revenue base. Relevant higher productivity sectors include manufacturing, construction, and tourism, which tend to absorb unskilled and semi-skilled labor.

Uganda's Economic Transformation Progress

- Structural transformation remains limited, despite a shift from an agriculture-driven to a services-driven economy. Transformation has been slow, with six in ten Ugandans dependent on agriculture employment. The combination of stagnant agricultural productivity and insufficient creation of higher value-added jobs slowed structural transformation after 2011.
- Uganda's labor productivity increased 3.9 percent annually between 1990 and 2011, largely driven by non-agriculture productivity gains underpinned by manufacturing and trade services. Labor productivity contracted 0.6 percent annually between 2012 and 2018.
- The main causes of the slow transformation are low labor productivity in agriculture, slow mechanization, limited innovation, and minimal business development and growth. Insufficient investment in higher productivity sectors is pushing agriculture labor into low-income informal trading.

Financing Structural Transformation in Uganda: The Need for Reforms in the Global Financial Architecture

- Uganda would benefit from reforms in the global financial architecture as these would help free up and mobilize more concessional finance to support its structural transformation and help to shift the balance away from expensive commercial borrowing that has increased in recent years.

- Stronger collaboration between international financial institutions to leverage finance from the domestic financial sector is needed to increase risk capital for investment, through blended finance and other credit enhancements to support the development of domestic manufacturing, formal mining, and construction.

- Increasing development finance to improve the competitiveness of its production factors, like transport, energy, and raw materials, would accelerate structural transformation. Uganda receives more than USD 2 billion annually from development partners, insufficient to address the public investment needs. Furthermore, just 5 percent of bilateral funding is directed towards education and 10 percent to productive sectors, mainly agriculture. Uganda could tap into EU's Global Gateway or China's Belt and Road investment initiatives to upscale production factors.

GENERAL INTRODUCTION

This year's edition of the African Development Bank's Country Focus Report for Uganda delves into the progress Uganda has made in structural transformation over the past three decades. The analysis builds on the African Economic Outlook 2024 and uses data from the Economic Transformation Dataset (ETD) compiled by Groningen Growth and Development Centre at University of Groningen, Netherlands (Kruse, Mensah, Sen, & Vries, 2022). The report applies the structural transformation analysis methodology proposed by McMillan, Rodrick, and Verduzco-Gallo (2014), using the definitions of sectoral labor productivity and labor productivity associated with structural shift, and the movement of labor from low-productivity sectors to high producitivty sectors.

The CFR is structured as follows: Chapter 1 presents recent macroeconomic developments and outlook. The chapter will discuss real economic growth and sector developments, and present recent developments in fiscal and monetary policy indicators and end with a brief discussion of the outlook and risks. Chapter 2 discusses Uganda's structural transformation over the past three decades and its drivers of transformation. Despite the shift from a largely agriculture-driven to services economy, the economy remains largely dependent on agriculture employment for six in ten Ugandans. Policy recommendations to accelerate structural transformation are provided at the end of the chapter. Chapter 3 explores ways of harnessing the reformed global financial architecture to support Uganda's structural transformation. The Report aims to dig deeper at the country level the analyses conducted at the continental level in African Economic Outlook Report (AEO, 2024). Each section proposes policy recommendations that would facilitate economic development and structural transformation.

RECENT MACROECONOMIC DEVELOPMENTS AND OUTLOOK

1

Key Messages

- Economic growth slowed in 2023, held back by contractions in food crop production and public administration, as well as flat manufacturing output. Real GDP growth expanded 4.6 percent from 6.3 percent growth in 2022. Over the medium term, the economy is expected to expand 6.0 percent in 2024 and 7.0 percent in 2025, as oil companies continue to ramp up investments, targeting production and exports for 2025.

- Price pressures continued to moderate in 2023, with an average inflation rate of 5.5 percent. To curtail inflation, the Bank of Uganda maintains a tight monetary policy rate at 10.25 percent. Higher growth and investment will sustain high levels of imports, keeping the current account deficit elevated above 8 percent of GDP.

- The government remains committed to fiscal consolidation narrowing the budget deficit to 5.1 percent in 2022/23. The deficit was estimated to decline to 4.2 percent of GDP in 2023/24, driven by cuts in current and investment spending more than increased domestic revenue mobilization.

- External risks to the growth outlook appear to be tilted to the upside. Global financial conditions are expected to ease as global prices stabilize, supporting more investment in global and domestic markets, which will further boost the Ugandan economy. Domestic headwinds stem from further delays in oil-to-market that may only happen in 2026, lower tax revenue mobilization, and slow implementation of public investments.

1.1 Introduction

This chapter presents an updated analysis of Uganda's economic performance for 2023, including medium-term growth projections. It assesses trends in key macroeconomic indicators, fiscal and monetary policies, and changes in domestic and international financial flows, investment and public debt. The chapter also discusses tailwinds and headwinds to the outlook and provide policy options to foster strong and resilient growth, as well as support macroeconomic stability and economic transformation.

1.2 Growth Performance

Macroeconomic stability continues to support Uganda's growth prospects, but more public investment needed to accelerate structural transformation and higher productivity.

The economy faced challenges in 2023, growing slower than the post-COVID-19 rebound. Despite strong domestic consumer demand and investment, overall economic growth slowed as government consumption slowed. The economy expanded 4.6 percent in 2023, lower than the 6.3 percent in 2022 (Table 1), but well above the East Africa average of 1.5 percent. Higher input costs and poor rain distribution led to a slowdown in agriculture output, which expanded just 1.9 percent in 2023, compared to 8 percent in 2022. Services also slowed to 4.2 percent, from 5.6 percent in 2022. Only the industrial sectors fared better in 2023, expanding 6.2 percent compared to 5.1 percent in 2022. Despite a difficult period during COVID-19 lockdowns in 2020 and 2021, and the commodity price rise in 2022, Uganda has managed to withstand the turbulence, underscoring the economy's resilience against external shocks. Agriculture has tended to be a stabilizing sector largely dependent on its domestic market and the bimodal nature of farming that reduces output volatility over a 12-month period.

Table 1 : Selected Macro indicators, Uganda

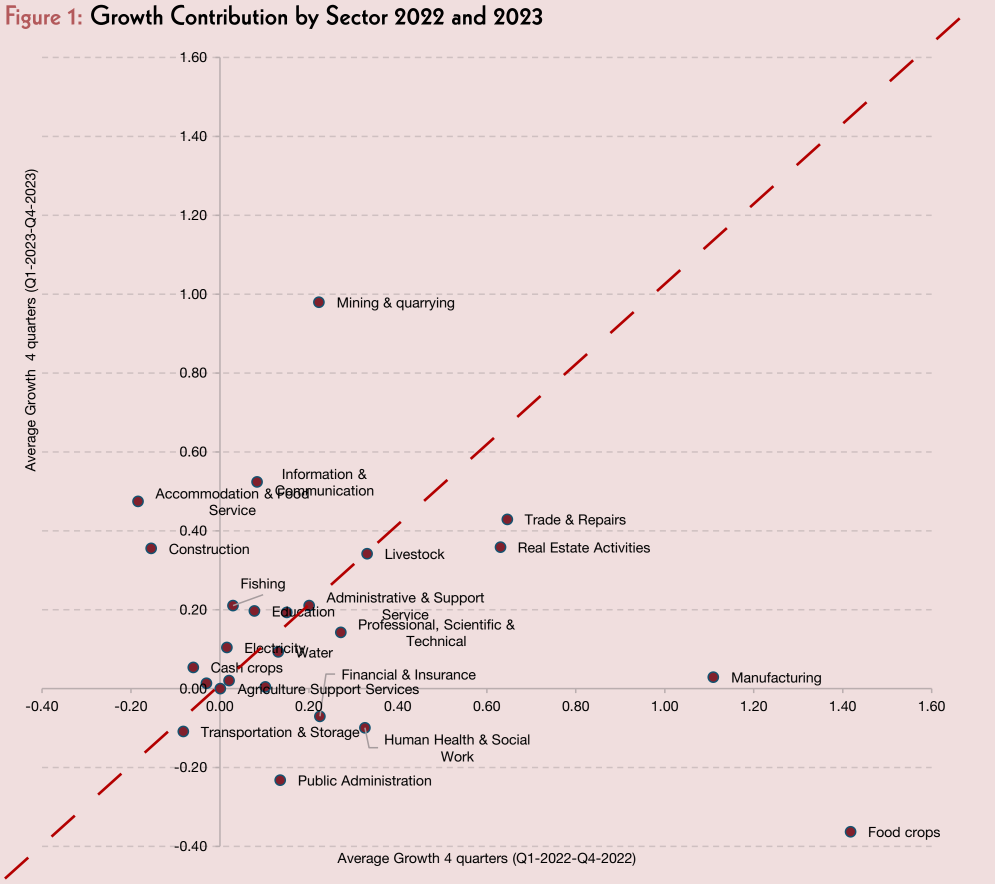
	2019	2020	2021	2022	2023 (e)	2024 (p)	2025 (p)
Real GDP Growth (percent)	7.6	-1.1	5.5	6.3	4.6	6.0	7.0
Real GDP Growth per Capita (percent)	4.2	-4.5	2.2	3.3	1.8	3.3	4.3
Inflation (percent)	2.1	2.8	2.2	7.2	5.5	4.5	5.0
Overall Fiscal Balance, incl. Grants (percent of GDP) *	-4.9	-7.3	-9.0	-7.4	-5.1	-4.2	-3.6
Primary Balance (percent of GDP) *	-3.0	-5.2	-6.3	-4.3	-1.9	-1.2	-0.7
Current Account (percent of GDP)	-6.9	-9.6	-9.2	-8.8	-7.9	-8.3	-8.8
Total Population (Millions)	42.9	44.4	45.9	47.2	48.6		
Life Expectancy at Birth (Years)	63.0	62.9	62.7	63.6	63.8		

*Source: Data from Domestic authorities; estimates (e) and prediction (p) based on authors' calculations. AfDB Statistics Department, April 2024. * Fiscal year: 31 July to June 30.*

The industrial sectors did well, led by mining and quarrying, and a rebound in construction. Manufacturing slowed considerably, from 7.3 percent in 2022 to just 0.3 percent in 2023, owing to higher borrowing rates and sluggish demand. The construction sector rebounded, expanding 5.7 percent from a contraction of 2.2 percent in 2022, buoyed by demand for housing. Further driving construction, are major public infrastructure projects in roads and rail, and construction of the East Africa Crude Oil Pipeline. Figure 1 provides a snapshot of growth contribution, i.e., growth of the subsector weighted against its size. Points above the 45-degree line indicate stronger growth in 2023 than in 2022. Five subsectors contracted in 2023—public administration by 8 percent, owing to slower increase in public expenditures.

Food crops, financial sector, human health and social work, and transport and storage also contracted in 2023. Food crops and manufacturing were key growth drivers in 2022, contributing over 1 percentage point (pp) each, but contracting or slowing in 2023.

Figure 1: Growth Contribution by Sector 2022 and 2023



Source: Uganda Bureau of Statistics

High interest rates reducing public spending and investment, increasing trade tensions, and regional conflicts are contributing factors in slowing growth. The high interest rates have reduced Uganda's ability to access cheap finance to invest in public infrastructure, while increasing the cost of non-concessional debt is linked to the Secured Overnight Financing Rate (SOFR), a cost measure of borrowing cash. The SOFR has remained close to 5.3 percent since August 2023, up from 0 percent in 2022, with commercial and non-concessional funders adding premiums of 2-5 percent depending on risk premiums. Domestic long-term treasury bonds trade at real interest rates of 9-11 percent. Private sector credit growth (8 percent) also remains subdued owing to the high cost of borrowing, affecting the private sectors willingness to make long-term capital

1.3 Other Recent Macroeconomic and Social Developments

Monetary Policy – inflation – exchange rates: The multiple shocks in 2022 and 2023 raised global energy and transport costs, driving up global inflation and tightening financial markets. Uganda's central bank, the Bank of Uganda, raised its policy rate from 6.5 percent to 10.0 percent in 2022, driving down inflation to 5.5 percent in 2023. Interest rates remain high. Although inflation declined to 3.2 percent in April 2024, inflation risk remains high, thus keeping the policy rate above

10 percent. The US Federal Reserve's rate reductions foreshadow a slowdown in the US job market. Despite high-level visits to strengthen ties, the trade environment between US, Europe and China remains uncertain. The Uganda Shilling remains largely stable against the US dollar, with a slight (2.4 percent) depreciation in 2023. Uganda was removed from the Financial Action Task Force grey list in February 2024, following the implementation of reforms to tighten anti-money laundering and anti-terrorism finance. This will benefit Uganda's reputation, positively affecting foreign direct investment and improving access to international financial markets.

Fiscal Policy – Public Debt: The government continues on a path of fiscal consolidation, squeezing development spending, and slowing growth in the process. The fiscal deficit was reduced to 5.1 percent of GDP in 2022/2023, from 7.4 percent of GDP in 2021/2022. Fiscal tightening has been on account of lower government consumption, rather than raising domestic revenue collections, which were 13.8 percent of GDP in 2022/2023. Due to subdued VAT and tax collections, overall revenues are estimated to fall 2.3-2.7 percentage points (pps) below the plan, with expenditure falling 2 pps short. The net effect will be an estimated deficit of 4.2 percent of GDP in 2023/2024, higher than the target of 3.6 percent of GDP. Fiscal consolidation supported the reduction of the primary deficit, which declined to 1.9 percent of GDP in 2022/2023, from 4.3 percent in 2021/2022. Debt servicing remains high, with interest payments of 3.2 percent of GDP in 2023. Deficits are financed through domestic and external borrowing. Public borrowing mounted during COVID-19, weakening public debt indicators. Public debt accumulation has since slowed and combined with fiscal consolidation, helped reduce debt stocks in 2023 to 47.6 percent of GDP. The main concern is the shift in the external debt mix, which has increased commercial borrowing from 0.7 percent in 2018 to 21.2 percent in 2023, combined with the higher international lending rates. The current sovereign debt rating by IMF is moderate risk of debt distress.

The rationalization of key government institutions, aimed at promoting efficiency and reducing the cost of the public sector, may affect performance capabilities. Allocation of sufficient funding for infrastructure maintenance remains a challenge. The government is paying more attention to project readiness through the Public Investment Management system, which will support better development outcomes. Nevertheless, low efficiency and quality of public investment weakens investment impacts. Despite higher public spending on infrastructure, Uganda lags behind its peers in efficiency (Kararach, et al., 2022; MFPED, 2023). This is attributable to weak governance and institutional capacity, which hampers public project planning, implementation, monitoring, and supervision.

External Position – External Financial Flows: The current account deficit improved in 2023 on account of the improved trade balance, with rising coffee and non-coffee exports. The current account deficit narrowed to 7.9 percent of GDP, from 8.8 percent of GDP in 2022. Although the services account deficit more than doubled in 2020 on account of lockdowns, tourists are returning to Uganda. Travel earnings surpassed USD 1 billion in 2023, within reach of the 2018 high. A resolution of the refined gold exports impasse in 2023 raised total goods exports by 64 percent from the previous year. The current account deficit is financed by development assistance, remittances, and foreign direct investment, which increased 16.4 percent to 11.7 percent of GDP in 2023. Following a decline in net capital inflows in 2022, increased oil investments bolstered net foreign assets by 11 percent, to USD 3.9 billion in 2023. International reserves remain unchanged from 2022, at 3.6 months of import cover.

Social Developments and Poverty – Achieving the Sustainable Development Goals requires significant investments: Uganda has been steadfast in its efforts to realize the aspirations of its people since adopting the 2030 Agenda for Sustainable Development. The country has made commendable progress in SDG coordination, implementation, monitoring, and reporting, and has aligned its national development plans and vision with the SDGs. Nonetheless, challenges remain. According to the latest Poverty Status Report 2021, Uganda's national poverty rate increased from 21.4 percent in 2017 to 30.1 percent in 2020, reversing the long-term downward trend. Poverty is higher in rural areas (33.1 percent) than in urban areas (19.8 percent), reflecting the challenges of subsistence farming, weather shocks, and informality. The Multidimensional Poverty Index Report 2022, measures aspects of poverty, such as education, health, and sanitation, which affect the welfare of households beyond consumption. The national multidimensional poverty rate was 55.1 percent in 2020, down from 61.4 percent in 2017, implying that more than half of the Ugandan population is still experiencing multiple deprivations. The Poverty Status Report examined vulnerability to poverty, which measures the likelihood of future poverty, and found that 54.7 percent of the population was highly vulnerable. Under half (48.8 percent) of the working population is in employment, and 89 percent is in informality, thus maintaining high income inequality of 0.413.

Vulnerability and Resilience: Uganda has pockets of vulnerability and conflict, yet it is a largely peaceful and stable country. The country has relatively strong capacity to cope with, adapt to and recover from shocks. Uganda has recorded progress in political, security, judicial, economic, social and environmental spheres. However, significant challenges undermine the country's development outcomes. Vulnerability is driven by governance deficits (47.5, in the Mo Ibrahim Governance Index), poverty and limited social security, high youth unemployment (16.5 percent), issues around gender equality, poor physical infrastructure (22.6, AIDI), poor quality education, regional insecurity, weak institutional capacities, environmental and climate vulnerabilities such as droughts and floods, prevalence of diseases, degradation of natural resources and some areas of food insecurity, mainly in Karamoja in the northeast. Uganda prides itself on a progressive refugee hosting policy, which aims to integrate refugees into society, and reduce tensions in host communities. The country hosts 1.5 million refugees, but not without challenges. Nevertheless, Uganda benefits from humanitarian aid, and refugees who spend USD 1 in host communities increase those communities' real incomes by USD 2 to 2.5 (Heng, et al., 2016). Refugees tend to cultivate land more intensely than domestic farmers, increasing yields per unit, and strengthening food security in the host communities.

1.4 Macroeconomic Outlook and Risks

Outlook: As global inflation moderates and financial conditions ease in the second half of 2024, investment will pick up, accelerating economic growth. Robust household consumption and large capital investments in the oil sector will boost growth on the demand side. Economic growth in the medium term is estimated to increase 6.0 percent in 2024 and 7.0 percent in 2025, supporting higher growth in East Africa by 4.9 percent and 5.7 percent, respectively. Price pressures are showing signs of abating, with 5 percent inflation expected over the medium term in line with the Bank of Uganda's medium-term target. However, businesses will push higher costs onto consumers to maintain their profit levels, while workers will try to increase wages to improve their purchasing power. Fiscal consolidation will remain on track, driven by the slowdown in government consumption and investment, which could moderate economic growth. In the medium term, the fiscal deficit estimates are 4.2 percent of GDP in 2023/2024, declining to 3.6 percent of GDP in 2024/2025. Consolidation will support the public debt reduction drive. The current account balance will remain elevated over the medium term, reflecting oil related investment imports. The current account deficit is projected to increase to 8.3 percent of GDP in 2024 and 8.8 percent of GDP in 2025. Beyond the review period, Ugandan oil is expected to flow to global markets from 2026, boosting growth and increasing tax-to-GDP 3-4 pps during peak production (CFR, 2023).

Risks: Global financial conditions are expected to moderate in the medium term as global inflation subsides, raising investment across global markets and boosting growth in Uganda. Headwinds on the domestic side stem from lower revenue mobilization, continued tight monetary policy to curb unexpected price pressures, and slow implementation of public investments. Climate change and poor rain distribution could impact agriculture, though bimodal areas will mitigate effects. In April 2024, the Constitutional Court upheld the most radical provisions in the 2023 Anti-Homosexuality Act, posing a risk to aid flows as some development partners have indicated reductions in aid allocations to Uganda. The World Bank delayed approval of new loans in 2023 until a safeguard review was completed.

1.5 Concluding Remarks and Policy Options to Foster Robust and Resilient Growth: Supporting Macroeconomic Stability and Economic Transformation

Uganda has maintained macroeconomic stability through a difficult period with multiple shocks. The tightening of global financial markets obligates Uganda to refrain from costly commercial borrowing and continue to consolidate its fiscal position by broadening the tax base rather than curtailing spending and public investment, which will moderate growth. From a policy position, the following strategies could accelerate economic transformation underpinning higher future growth.

Short- to medium-term policy measures

Maintaining economic stability and continuing reforms will attract more investment inflows, thereby supporting Uganda's economic transformation. Uganda has diligently implemented macroeconomic stabilizing policies—prudent adjustment of monetary policy to stabilize prices and the exchange rate—and fiscal consolidation.

Uganda should scale-up its domestic revenue mobilization to maintain high levels of public investment and spending on social services. Revenue mobilization remains behind its regional peers, with a narrow tax base and an economy, which largely relies on informality that is difficult to tax. Broadening the tax base, not just for taxation, but for the registration of informal businesses to help protect entrepreneurs' rights, entitlements and assets. The attractiveness of the formal sector can be enhanced by providing greater access to financial resources and information, pension schemes, social insurance, or other incentives. Authorities could also consider simplifying the tax structure and improving tax competitiveness through phased corporate tax reductions to attract investors, while rationalizing tax incentives and improving tax compliance and enforcement. This could attract more foreign and domestic investment and stimulate private sector development. These strategies require strengthening the capacity of the tax administration and improving the transparency and accountability of public spending to increase taxpayer trust and willingness to pay.

Medium- to long-term policy measures

Improving public investment efficiency and quality would contribute to accelerating structural transformation. The government should accelerate the implementation and rollout of the public investment management system to improve public investment efficiency and project prioritization. This includes strengthening governance and institutional capacity to design, appraise, select, and manage public projects; and basing projects on sound cost-benefit analyses. Improving monitoring and supervision of public projects, by enhancing transparency and accountability of public procurement and contracting processes, and by strengthening oversight and audit functions, should also be pursued. This would reduce poor project management and support value for money.

2

TAKING STOCK OF UGANDA’S STRUCTURAL TRANSFORMATION PROGRESS

Key Messages

- Structural transformation remains limited, despite the shift from a largely agriculture-driven to services economy. The economy remains dependent on agriculture employment for six in ten Ugandans. Stagnant agricultural productivity, combined with insufficient creation of higher value-added jobs, slowed structural transformation after 2011.

- Uganda’s labor productivity increased 3.9 percent annually between 1990 and 2011, largely driven by non-agriculture productivity gains underpinned by manufacturing and trade services. Labor productivity contracted 0.6 percent annually between 2012 and 2018.

- The main causes of slow transformation are low labor productivity in agriculture, slow mechanization, minimal technological innovation, and limited creation of higher value-addition jobs. Low income and poverty are pushing agriculture labor into low-income informal trading.

2.1 Introduction

Structural transformation is the process by which an economy shifts from a low-productivity, low-income, and low-diversity structure to a high-productivity, high-income, and high-diversity structure. It involves changes in the sectoral composition of output and employment, as well as changes in the technological and institutional features of production and distribution. Uganda's situation is much the same as the average African country, which is transforming without significant industrialization but through low-skill services because business development and jobs in manufacturing have been limited. Increasing labor productivity and accelerating structural transformation, by establishing the foundations for industrialization, applying the right industrial policies and accessing finance, is essential for achieving sustained and inclusive economic growth and development. According to Krugman (1994, p. 1), "productivity isn't everything, but, in the long run, it is almost everything…a country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker". The task ahead of Uganda is clear. It must lay the foundations for improving labor productivity and domestic production competitiveness, to attract more private sector investment in sectors with higher value-added.

This chapter's main objective is to analyze the drivers, patterns, and outcomes of Uganda's structural transformation since the 1990s, and to identify the main challenges and opportunities for accelerating and deepening this process in the future. Section 2 presents key economic performance and transformation from the 1980s to date. Section 3 presents the main features and trends of Uganda's structural transformation, using various data sources and methods. The section will also discuss the main factors and policies that have influenced Uganda's structural transformation, focusing on the role of macroeconomic stability, trade openness, infrastructure, human capital, innovation, and institutional quality. Section 4 presents Uganda's main national programs that drive structural transformation and provides some insights into the financing needs and gaps. Section 5 concludes with some policy implications and recommendations for fast-tracking Uganda's structural transformation and achieving higher and more inclusive growth and development.

2.2 Taking stock of economic performance and transformation in Uganda

Uganda is a landlocked East African Community member country with a population of 45 million. Uganda is classified as a low-income country. Over the past four decades, its economy has transformed from largely agricultural to service-driven. Over much of the of the 1980s, which was a period of civil war and political instability, inflation rose above 150 percent, private sector credit reduced, the country's real economy stagnated, and per capita incomes declined. With the National Resistance Movement taking control of government in 1986 and stabilizing the political situation, the country embarked on a series of market-oriented reforms: liberalization of sectors; simplification of administrative and investor procedures; implementation of the Economic Recovery Program (ERP) from 1987 to 1992, and Structural Adjustment Programs, orienting the economy towards private sector-led growth, while attracting domestic and foreign resources for development; and privatizing public enterprises (EPRC, NA). These reforms supported economic activity and, between 1990 and 2023, raised average GDP growth to 6.2 percent, one of Africa's highest (Figure 2a). Uganda also achieved substantial reductions in poverty and improvements in human development indicators, such as literacy, maternal mortality, and life expectancy.

Figure 2a: Real GDP Growth (percent)

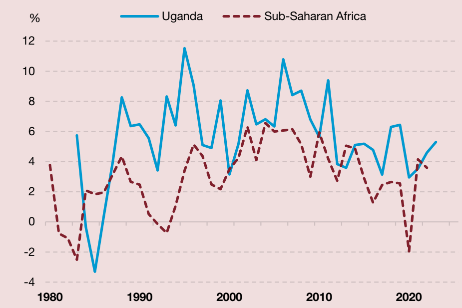


Figure 2b: Sector Contribution (percent of GDP)

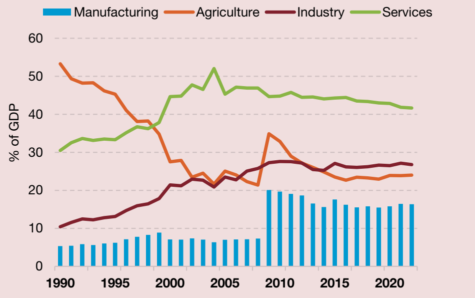


Figure 2c: GDP per Capita and Growth (percent)

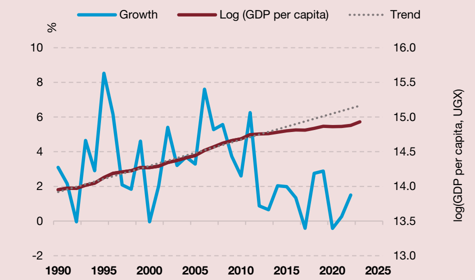
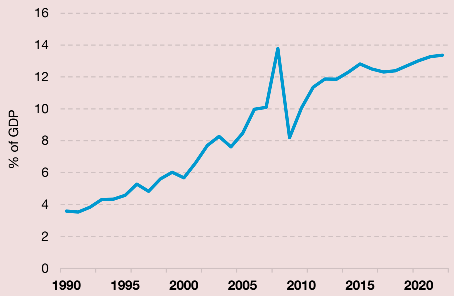


Figure 2d: Domestic Credit to the Private Sector (percent)



Source: WDI

Since 1990, Uganda's real economy has expanded 7-fold, reaching USD 45.6 billion in 2023. This is a considerable change for a country torn by a civil war in the mid-1980s. Adjusting for a 3.2 percent population growth, income levels have expanded just 2.6-fold to USD 964 in 2023. During the 1990s and the 2000s, reforms were changing the economy, Ugandans were optimistic about the future, and private sector credit growth was high, rising from 2.8 percent of GDP (1988) to 13.8 percent of GDP (2008), increasing consumption and investments. Debt relief was completed in 2005, reducing the debt burden, and increasing the government's fiscal spending space for even more public investments. In 2009, the global financial crisis changed that, as domestic credit to the private sector dropped by over 5 percentage points (Figure 2d). Economic reforms slowed and optimism declined, with private sector credit growth stagnating in the 2010s. As illustrated in Figures 2a and 2c, growth and growth per capita shifted downwards. The European Debt crisis, which followed in 2011, ended Uganda's strong growth era. Economic growth averaged 7.1 percent between 1990 and 2011 and declined to 4.6 percent between 2012 and 2023 (Figure 2c).

Uganda's economic performance is also characterized by some major challenges. Among the major challenges is the limited and uneven pace of structural transformation. Despite the rapid growth of the economy, Uganda remains largely dependent on agriculture, contributing a quarter of GDP (Figure 2b) and employing two thirds of workers. Industrial contribution has been stagnant at 27 percent of GDP for the past decade, employing one in ten workers. After the national accounts rebalancing, manufacturing contribution was adjusted to 20 percent of GDP, after more informal manufacturing was captured in the data. The sector has since declined to 16 percent of GDP. The services sector saw remarkable growth between 1990 and 2004, when contribution peaked at 52 percent of GDP. The services sector's contribution has since declined to 42 percent of GDP, employing 28 percent of the workforce. The sector is dominated by low-productivity and informal activities,

Structural transformation remains limited with six in ten Ugandans still working in low productivity agriculture.

such as trading, boda-bodas (urban motorcycle taxis), and personal services. Uganda's export basket is narrow and concentrated in primary commodities, such as coffee, tea, fish, and gold, subject to price volatility and external shocks.

2.3 Uganda's Structural Transformation: Drivers, Bottlenecks, Opportunities

The literature on structural transformation goes back to early works (Lewis, 1954; Kuznets, 1959; Chenery & Syrquin, 1975; and Syrquin, 1988) that examined the features and preconditions for economic growth. More recently, Rodrick and Mensah (2014) analyze labor productivity by breaking down two components of changes. At the country level, overall labor productivity can be analyzed through two key factors: i) how efficient resources are allocated between industries or sectors, which relates to the mobility of labor; and ii) how intra-industry efficiency can be enhanced by innovating and adopting new technology to increase industry productivity. The first component in labor productivity is concerned with employment movements between sectors. Labor shifting from low productivity sectors to high productivity sectors will increase country-wide labor productivity, promoting economic transformation, termed "structural". The second component is associated with improved technology and innovation, which increases labor productivity from "within" a sector.

Table 2: Labor Productivity Across Sectors

	Labor productivity (USD 2015 const)			Annual change (%)			Relative Labor Productivity	
Sector	1990	2011	2018	1990-2011	2011-2018	1990-2018	1990	2018
AGR	1,719	2,508	2,163	1.8%	-2.1%	0.8%	62	37
MIN	1,901	10,336	5,097	8.4%	-9.6%	3.6%	69	88
MAN	2,675	11,874	10,543	7.4%	-1.7%	5.0%	97	181
UTI	43,799	449,288	382,533	11.7%	-2.3%	8.0%	1,587	6,576
CON	7,074	17,662	20,017	4.5%	1.8%	3.8%	256	344
TDS	3,021	8,009	7,990	4.8%	0.0%	3.5%	109	137
TRS	4,587	8,584	7,584	3.0%	-1.8%	1.8%	166	130
BUS	24,189	54,302	57,030	3.9%	0.7%	3.1%	876	980
FIN	16,884	72,149	77,713	7.2%	1.1%	5.6%	612	1,336
REA	795,026	409,809	527,294	-3.1%	3.7%	-1.5%	28,800	9,064
GOV	14,992	16,502	12,625	0.5%	-3.8%	-0.6%	543	217
OTH	2,426	3,777	3,981	2.1%	0.8%	1.8%	88	68
UGA	**2,761**	**6,081**	**5,817**	**3.9%**	**-0.6%**	**2.7%**	**100**	**100**
CV							0.223	0.203

Note: Labor productivity is value addition in USD 2015 prices adjusted for sector employment. AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. UGA, Uganda. CV, coefficient of variation. Source: ETD.

Uganda's structural transformation

This section presents the main features and trends of Uganda's structural transformation since the 1990s, using various data sources. We first analyze the period changes in the sectoral composition of employment and labor productivity in levels and relative to the country average using data from ETD covering 1990 to 2018. We then analyze relative labor productivity shifts and the productivity drivers and end this section with a discussion on constraints slowing structural transformation. Uganda's structural transformation is compared with other countries', highlighting some of the main similarities and differences.

Between 1990-2018, Uganda's national labor productivity grew on average by 2.7 percent annually, reaching USD 5,817 per employee in 2018. Productivity growth was stronger between 1990 and 2011 at 3.9 percent, while growth declined to 0.6 percent annually after the global financial crisis (Table 2). There are wide variations across sectors. Labor productivity in utilities and real estate was 66 and 91 times the national average in 2018. Agriculture, the least labor productive was 37 percent of the national average. For manufacturing and construction, labor productivity was 1.8 and 3.4 times the national average. After 2011, several sectors experienced declines in labor productivity, with manufacturing productivity declining by 1.7 percent annually and mining 9.6 percent annually, owing to the influx of workers into informal mining.

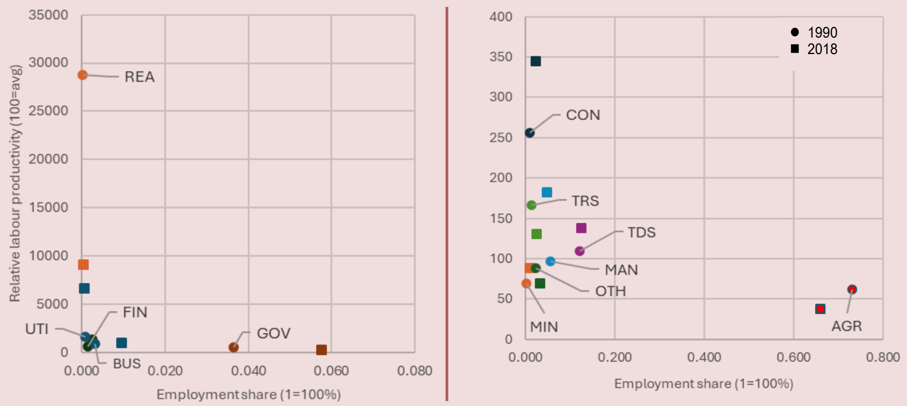
Uganda's labor market is characterized by early-stage development at which most of the 14.8 million labor force is concentrated in agriculture. Agriculture workers increased from 4.6 million workers, 73 percent of the workforce, in 1990 to 9.8 million in 2018, or 66 percent of the workforce (Table 3). Other sectors that absorbed labor were trade and retail (1.9 million workers) and the combined industrial sectors (1.2 million workers). However, these sectors were not growing fast enough to absorb excess agriculture labor, thus contributing to reduced labor productivity in agriculture. Within the region, Kenya and Tanzania show similar agriculture labor trends, while Rwanda has stabilized the number of agriculture workers, with new jobs solely created in non-agriculture sectors.

Table 3: Employment Share Across Sectors and Relative Labor Productivity

Sector	1990	2011	2018	1990-2018 (pps)
AGR	73.1%	66.6%	66.0%	-7.1
MIN	0.2%	0.3%	1.0%	0.8
MAN	5.7%	5.1%	4.9%	-0.8
UTI	0.1%	0.0%	0.1%	-0.0
CON	1.0%	2.6%	2.5%	1.5
TDS	12.1%	14.2%	12.5%	0.4
TRS	1.4%	2.1%	2.6%	1.1
BUS	0.3%	0.8%	1.0%	0.6
FIN	0.2%	0.2%	0.3%	0.1
REA	0.0%	0.1%	0.1%	0.0
GOV	3.6%	4.8%	5.8%	2.1
OTH	2.3%	3.1%	3.4%	1.1
TOT	100%	100%	100%	

Note: AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. TOT, total. PPS, percentage points. Source: ETD.

Figure 3: Relative Labor Productivity and Employment Share of Sectors (1990 and 2018)



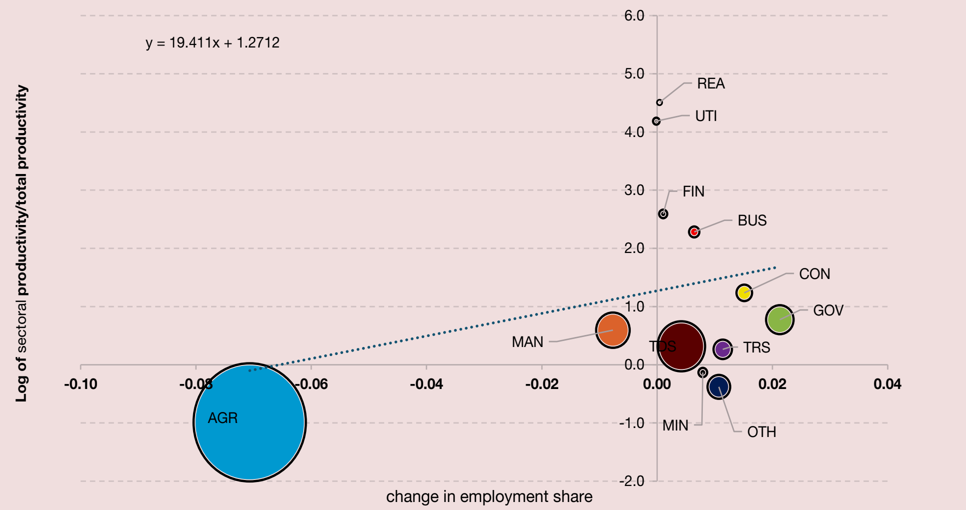
Note: AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. Source: ETD.

Unpacking Uganda's structural transformation through labor productivity decomposition

The labor productivity variations are analyzed across 12 sectors, using ETD. Figure 3 presents labor productivity relative to the country average on the vertical axis and the sector's employment share on the horizontal axis. To analyze the change in labor productivity over time, there are two datapoints for each sector, with the circle denoting 1990 and the square 2018. Real estate services (e.g. housing and commercial) and utilities (e.g. power plants and water treatment) demonstrate very large labor productivity, associated with the large capital investment component in these sectors relative to the labor allocated. Both sectors have small employment shares with less than a tenth of a percent. Business and financial services are also high productivity subsectors with lower capital use, and with relatively low absorption for low-skilled workers. Most workers in these sectors have at least higher secondary or tertiary education skills. Manufacturing and construction have above average labor productivity, and relatively moderate labor absorption. The employment share of manufacturing (4.9 percent) has been declining in recent years, whereas construction stabilized at around 2.5 percent. Transport and trading services are 30 percent and 37 percent above average labor productivity, with trading services absorbing 12.5 percent of labor and transport 2.6 percent of labor, much of it informal. Agriculture with the lowest labor productivity, has an employment share of two-thirds of the labor force (Figure 3). The sector relies on abundant land and people to cultivate it, with very little capital input. Two other sectors below the national average are mining, mainly informal artisanal mining, and personal services, both highly informal. The sectors are absorbing increasing levels of labor, from 2.5 percent in 1990 to 4.4 percent in 2018, mainly because of the relative ease of entry into these sectors.

Uganda's productivity gaps are narrowing as evidenced by the narrowing of the coefficient of variation from 0.223 to 0.203 between 1990 and 2018. The labor share of agriculture declined 7.1 pps since 1990 but also experienced a decline in relative labor productivity. Labor has moved to higher productivity sectors, including government, transport services and construction. Agriculture labor is transitioning to other sectors, but sectors like manufacturing, construction and trading services are not creating enough jobs to absorb substantial amounts of low-skilled agricultural labor. The sluggish employment drift from agriculture and low value addition engendered a decline of relative labor productivity in agriculture between 1990 and 2018.

Figure 4: Correlation Between Sectoral Productivity and Change in Employment Shares in Uganda (1990–2018)



Note: The size of the circle shows the relative size of employment in each sector in 1990. AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. Source: ETD.

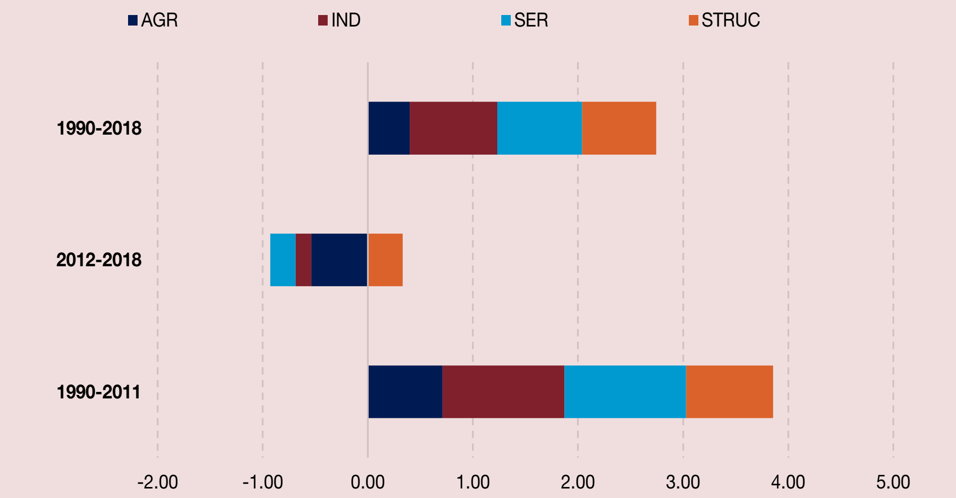
For structural transformation to be growth-enhancing, employment from lower productive sectors is expected to move into higher productive sectors so that sector productivity converges towards the average, i.e., productivity gaps diminish between sectors (McMillan, Rodrick, & Verduzco-Gallo, 2014). Figure 4 provides insights into Uganda's structural transformation and examines whether it is growth enhancing. Labor from below average agriculture has moved to higher-than-average productivity sectors such as retail and trade, government, and construction. However, some labor has also moved into lower-than-average productivity sectors like mining and personal services, putting a drag on growth. The trendline is positive, indicating a growth-enhancing structural change. A breakdown of the data for 2011 and beyond show a different shift in labor (Figure A1-9). Agriculture's share of employment continues to decline, but now employment shares from retail trade and construction, which are above average productivity sectors, are also declining, thus dampening structural transformation and growth.

Using McMillan et al.'s (2014) methodology, we examine labor productivity broken down by "within" and "structural" associated with the move of labor from lower productivity sectors to higher productivity sectors.[1] Over the 1990-2018 period, Uganda's labor productivity expanded 2.7 percent annually (Figure 5). Most of the increase (2.0 percent) was contribution from within the sectors through improved technology, mechanization, innovation and capital investment. The structural contribution, switching from lower productivity sectors to higher productivity sectors, expanded 0.7 percent annually. Examining the period before and after 2011 shows marked differences in Uganda's labor productivity. The period 1990-2011, labor productivity averaged 3.9 percent, of which structural change accounted for 0.8 percent, annually. Between 2011-2018,

[1]For more information on the methodology for disaggregating labor productivity, see Annex 1.

Uganda experienced overall slower real growth and declining labor productivity. In fact, there was a significant decline in "within" sector labor productivity, as all sectors combined declined 0.9 percent. Agriculture declined 0.5 percent, industry 0.2 percent, and services 0.2 percent. The decline in labor productivity was somewhat offset by structural change, increasing 0.3 percent annually. On the whole Uganda's labor productivity has declined since the global financial crisis and the European Debt crisis. Comparing structural change from within the region, Uganda's structural change has been lower than Rwanda (3.7 percent) and Tanzania (1.2 percent), although overall labor productivity was slightly lower than Uganda's in both countries—3.3 percent for Rwanda and 3.1 percent for Tanzania.

Figure 5: Labor Productivity from Within the Sectors and from Structural Change



Source: ETD

Uganda is not particularly industrially competitive in the global market. Uganda's manufacturing sector ranks 123rd out of 153 countries, according to the Competitive Industrial Performance (CIP) Index. The production structure is mostly resource-based, with relatively little diversification and sophistication, resulting in a score of 0.133 (the higher the score, the more diversified and sophisticated the production structure), ranking 110th out of 153 countries in 2021. Uganda's export structure is slightly more diversified and sophisticated, with a score of 0.237, ranking 96th out of 153 countries. Most of Uganda's manufacturing exports are characterized by low-tech exports accounting for 79.2 percent between 2010 and 2021. Medium- and high-tech exports account for 20.8 percent of exports. In comparison, Kenya exported 20.4 percent and Rwanda 23.3 percent in medium- and high-tech products in 2021. According to the Observatory of Economic Complexity's (OEC) Product Space Analysis, Uganda's production and export structures were concentrated in a few clusters of products, mainly related to agriculture, food, and minerals, and had few linkages and opportunities for moving to more complex and higher-value products, such as machinery, chemicals and electronics.

Drivers of accelerated structural transformation

In the following section, we turn to the main factors that have helped drive structural transformation in the Ugandan context, based on evidence from AEO (2024). It is noteworthy that Uganda has achieved an incredible degree of macroeconomic stability since the 1990s, when it adopted a series of market-oriented reforms and embarked on political stabilization. Uganda has maintained low and stable inflation, averaging 5.4 percent between 2000 and 2022, and a moderate fiscal deficit, averaging 3.8 percent of GDP over the same period. Macroeconomic stability has facilitated structural transformation by creating a favorable environment for investment, saving, and growth, and by reducing uncertainty and excess volatility.

Table 2: Labor Productivity Across Sectors

Dependent variable: Structural change term	-1	-2	-3	-4	-5	-6	-7
Total natural resources	-0.0056	-0.0038	-0.0144*	-0.0128	-0.013	-0.0141	-0.0141
	(-0.005)	(-0.007)	(-0.009)	(-0.009)	(-0.009)	(-0.011)	(-0.01)
Undervaluation index		0.5998***	0.7224***	0.7717***	0.7933***	0.8749***	0.8831***
		(-0.218)	(-0.22)	(-0.209)	(-0.216)	(-0.272)	(-0.264)
Employment rigidity index			-0.0536**	-0.0604**	-0.0632**	-0.0646**	-0.0680**
			(-0.023)	(-0.025)	(-0.026)	(-0.027)	(-0.031)
Governance Quality				0.0271*	0.0245	0.0254	0.0253
				(-0.016)	(-0.016)	(-0.017)	(-0.017)
Gross fixed capital					0.1915**	0.1966**	0.1878*
					(-0.093)	(-0.091)	(-0.095)
Human capital						0.2102	0.2988
						(-0.442)	(-0.457)
ICT Infrastructure							-0.0103
							(-0.018)
Constant	-1.59***	-1.58***	-1.11**	-2.00**	-2.51**	-2.77***	-2.80***
	(-0.573)	(-0.577)	(-0.528)	(-0.968)	(-1.065)	(-0.897)	(-0.877)
Observations	909	909	854	842	842	756	756
R-squared	0.427	0.43	0.436	0.441	0.441	0.444	0.444
Number of groups	48	48	46	46	46	41	41

Note: Standard errors in parentheses.
**** Coefficient at 1 percent significance level. ** Coefficient at 5 percent significance level. * Coefficient at 10 percent significance level. Each column contains unreported year dummies and regional dummies. The choice of the explanatory variables included in the regression is informed by the existing literature (McMillan et al, 2014; van Neuss, 2018; Martins, 2019; Dappe and Lebrand, 2024), while the sample size and period of analysis are determined by data availability. Regression was done using Least squares dummy variable model (LSDV) with Driscoll-Kraay standard errors. Source: Reproduced from AEO (2024).*

By regressing structural change on possible determinants, the AEO (2024) identifies several determinants that positively influence structural transformation (Table 4). These include the exchange rate, employment conditions, institutional and governance quality, and investment. The regression dismissed natural resource rents as an explanatory variable having no significant effect on structural transformation when other variables were included. The first significant determinant is the exchange rate. The regression indicates that an undervalued exchange rate has a positive effect on structural change. Uganda has maintained a flexible exchange rate, which has helped to absorb external shocks and maintain competitiveness. Another important determinant is the degree of labor market flexibility. More flexible labor markets facilitate labor movement from low productivity to higher productivity jobs. Uganda's labor market is mostly informal, with 90 percent working in the informal sectors with little regulation and high adaptability, allowing easy entry and exit into unskilled and semiskilled sectors. Uganda's formal labor market, which is more characteristic of higher productivity jobs, is somewhat rigid, making it more difficult to shed labor during hard economic times. This also implies that businesses will be more reluctant to hire new workers, as future labor shedding could become costly. This can particularly reduce the ability of less experienced youth to enter the labor market. Table 4 further indicates that better governance and stronger institutions provide a more conducive environment for structural change. Better governance and stronger institutions increase accountability and transparency, which can lead to improved public investment and value for money, thus increasing investor confidence. Since the 1990s, Uganda has gone from a state-interventionist economy to a liberal capitalist economy liberalizing creating an enabling environment for the private sector to operate (Byiers, et al., 2015). Finally, investment in public and private infrastructure is an enabler of structural transformation. Uganda has invested heavily in transport, linking the different regions of the country. Investment in energy generation has further enabled the private sector and industry to access low-cost electricity to drive transformation.

Major impediments to fast-paced structural transformation

Manufacturing, a sector with strong backward and forward linkages to the rest of the economy, is still relatively undeveloped in Uganda. There could be many reasons for this. One plausible explanation is the low rate of urban agglomeration (25 percent). According to Pozhidaev (2020), expanding secondary cities with good public services and infrastructure for industrialization can spur business development and job creation in higher productivity sectors, thus improving the quality of growth and reducing poverty. Investment into industrial sectors, such as manufacturing, is relatively low, which can be explained by inadequate domestic credit to the private sector. Domestic credit to the private sector is just 13 percent of GDP, with annual credit growth of 10.2 percent between 2012-2023, compared to 21.7 percent between 1994-2011. Despite relatively large investments into public infrastructure, this may not be enough. Roads are not well maintained and deteriorate, the quality and stability of electricity affects equipment, and access to clean water is often needed for agro-processing. Kampala, along with the surrounding northern corridor, is a magnet for manufacturing. However, at the same time, the city is becoming more congested, and public transport infrastructure is not keeping pace with the needs for efficient and competitive transport logistics.

2.4 Finance to Fast-Track Uganda's Structural Transformation: How much is at stake? Uganda's commitment to structural change

This section assesses Uganda's structural transformation agenda through its National Development Plan and the main national programs aimed to accelerate structural changes in the country.

Vision 2040 is the apex document outlining Uganda's economic transformation vision. The Vision aims to transform Uganda from a low-income country to a competitive upper-middle-income country by 2040. It envisions the transformation of the

Ugandan society from a peasant to a modern and prosperous country. The key agenda to drive the transformation hinges on the following:

- Economic Diversification: diversifying the economy from a primarily agrarian-based economy to an industrialized and service-oriented economy. This includes increasing value addition in agriculture, promoting industrialization and expanding the service sector. Uganda has made much headway in increasing the value addition of the industry and services sectors, which account for more than 70 percent of the economy, although job growth in these sectors is sluggish.
- Infrastructure Development: investing in infrastructure is critical to the facilitation of economic transformation. This includes improving transportation networks (roads, railways, air transport), energy infrastructure (expanding electricity generation and distribution), and ICT infrastructure. There is still much to do on infrastructure expansion, as Uganda scores very low (22.6) on the Africa Infrastructure Development Index
- Human Capital Development: Investing in education and health to develop a skilled and healthy workforce should be emphasized. This involves improving the quality of education, expanding vocational training, and enhancing healthcare services. Uganda is making strides in the Human Development Index reaching 0.55 (2022) and classified as medium human development.
- Urbanization: encouraging urbanization as a driver for economic growth, with planned development of cities and urban areas to create economic hubs.
- Innovation and Technology: promoting innovation and technological advancement through research and development and creating an enabling environment for technology adoption across sectors.

The five-year National Development Plans provide the strategic and programmatic approach to operationalizing the agenda. The current Plan focuses on enhancing Uganda's competitiveness for sustainable wealth creation, employment, and inclusive growth. Structural transformation will be pursued through industrialization, agriculture modernization, private sector development, skills development, export promotion, governance and institutional strengthening and service delivery. Industrialization is seen as a key pillar for structural transformation. It aims to increase the manufacturing sector's contribution to GDP by promoting agro-industrialization, mineral beneficiation, and light manufacturing. Agricultural modernization and the recent rollout of the Parish Development Model are seen as transforming agriculture from subsistence farming to commercial agriculture, while integrating rural populations into the money economy. Modernization entails improving agricultural productivity through mechanization, better agricultural practices, and increasing access to markets, and granting rural populations access to finance. Membership of the East Africa Community and the ratification of the African Continental Free Trade Area (AfCTA), provide easier access and larger markets for Uganda's manufacturing subsectors, and can help spur investment in these subsectors.

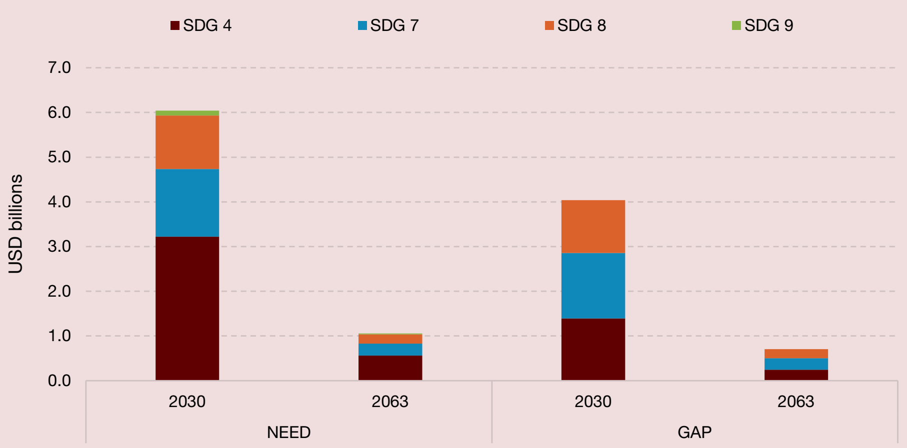
Financing needs and financing gap

The AEO (2024) provides insights into how much Uganda would need to spend, if it aspires to the same level of performance as benchmark developing countries in sectors critical to structural transformation. The annual financing needs and the associated financing gap is estimated for the 2030 Agenda for Sustainable Development and the African Union's Agenda 2063 by assigning the median input levels and controlling for other factors such as projected demographics (population size and composition, and so on) and the level of GDP per capita. With just 6 years to 2030, there is need to accelerate investment to meet the targets in the SDG 2030 agenda. The Africa 2063 is still somewhat far, allowing more time to spread out the cost over four decades. However, given that Vision 2040 is the driver of the agenda for Uganda, the actual needs are somewhere in between the two points. The needs for meeting quality education goal, SDG 4 by 2030, are 3.2 percent of GDP, and a current gap of 1.4 percent of GDP. Clean energy, SDG 7; and decent work, SDG, 8; have similar financing gaps. Industry, innovation and infrastructure, have a need of 0.1 percent of GDP, with no gap—an indication that that this area is already meeting the financing requirements. The total needs for these SDGs are USD 6 billion annually, with a gap of USD 4 billion.

Closing the financing gap through domestic resource mobilization

To close the financing gap, Uganda needs to increase the tax-to-GDP ratio by 7.3 pps in the 2030 scenario, while Agenda 2063 allows a slower adjustment, reducing the required increase to 1.3 pps (AEO, 2024). With oil flows coming on stream in 2025/2026, Uganda will be able to finance most of its needs to accelerate structural transformation, as oil revenues at peak production will reach 3 percent to 4 percent of GDP.

Figure 6: **Financing Needs and Gaps**



Source: Staff calculations and database from African Development Bank statistics.

2.5 Concluding remarks and policy recommendations

Conclusion

Evidence suggests that Uganda has experienced a limited shift of jobs from lower productivity sectors to higher productivity sectors. Structural transformation has been uneven, as evidence shows that transformation was strongest in the period 1990 to 2011. In the period after the global financial crisis and the European debt crisis, structural transformation slowed, and labor productivity declined. Compared to developing Asia in the 1990s, structural transformation is slower in Uganda, and half as strong as the structural transformation in non-resource intensive African countries in the 2010s.

The key drivers of structural transformation are exchange rates, flexible labor market, governance and strong institutions, and investment in an enabling environment (public infrastructure).

Policy Recommendation

Short to medium term policy measures

Investing in human capital and increasing skills in youth and in labor can facilitate structural transformation. Uganda has large gaps in meeting SDG 4 on education, which requires increased levels of funding. These resources can come through reforms in the global financial architecture, but domestic resource mobilization needs greater attention. Oil revenues are anticipated from 2026 can support more investment in education.

Medium- to long-term policy measures

Improving governance and strengthening institutions will have a profound effect on structural transformation and economic growth. Government is rationalizing public institutions with the aim of streamlining and increasing public efficiency. The quality of the rationalization reforms will determine the speed of Uganda's structural transformation. Ownership of the country's development plans and improvement in accountability and transparency will further support transformation. Building strong institutions to support better public services will help attract investment and accelerate structural change.

Developing secondary cities and improving the quality of services in urban areas can have positive agglomeration effects, attracting more investment to manufacturing and driving structural transformation, improving incomes and raising wealth. Urbanization is still in the early stages in Uganda. Strengthening the role of secondary cities to drive transformation can be achieved through improved frameworks to allow cities to collect revenues on a wider scale and strengthen their fiscal space.

Expanding quality infrastructure to lower the cost of production factors can support a more competitive investment and business environment to drive transformation. Uganda lacks competitiveness on its most basic foundations for structural transformation. Upscaling and improving public infrastructure, where it matters most, can enable faster development and job growth.

3

FINANCING UGANDA'S STRUCTURAL TRANSFORMATION: THE NEED FOR REFORMS OF THE GLOBAL FINANCIAL ARCHITECTURE

Key Messages

- Uganda would benefit from reforms in the global financial architecture, as these would help free up and mobilize more concessional finance to support its structural transformation and help to shift the balance from expensive commercial borrowing, which has increased in recent years.

- Stronger collaboration between international financial institutions to leverage finance from the domestic financial sector is required to increase risk capital for investment, through blended finance and other credit enhancements to support development of domestic manufacturing, formal mining, and construction.

- Increasing development finance to improve the competitiveness of its production factors, like transport, energy and raw materials, would accelerate structural transformation. The more than USD 2 billion Uganda receives annually from development partners is insufficient for the public investment needs. Furthermore, just 5 percent of bilateral funding is directed towards education and 10 percent to productive sectors, mainly agriculture. Uganda could tap into EU's Global Gateway or China's Belt and Road investment initiatives to upscale production factors.

3.1 Introduction

The chapter discusses Uganda's position on reforms in the Global financial architecture and the external financing required to achieve Uganda's structural transformation, while tackling the challenge of climate change. It uses estimates on financing needs and gaps to accelerate structural transformation (AEO, 2024) and to fund climate actions by 2030 (AEO, 2022; AEO, 2023; CFR, 2023). Based on the Bank's estimates, the chapter evaluates Uganda's ability to raise the tax-to-GDP ratio to close the financing gap for the acceleration of the structural transformation by 2030 and 2063, and highlights the needs for reforms to the global financial architecture.

3.2 Uganda's Stand on the Need for Reforms of the Global Financial Architecture

This section discusses Uganda's position on the reforms of the Global financial architecture and explores ways Uganda is expected to benefit from these reforms to raise external resources required to fast-track structural transformation. It discusses challenges that Uganda faces in raising international capital at affordable credit terms.

Uganda has joined the call for action to reform the Global financial architecture and its ability to support poor developing countries. During the G77 meetings in Kampala in January 2024. President Museveni[2] emphasized the need for urgent reform of the international financial system to make it more responsive to the financing needs of developing nations without imposing conditionalities that infringe on their sovereignty. Museveni further stated: "Uganda's Chairmanship will strive to further promote: acceleration of the implementation of the 2030 Agenda; scaling up action to address climate change and biodiversity loss; strengthening international tax cooperation; financing for development; fight against illicit financial flows…" (NRM, 2024).

Uganda has proposed changes, which included overhauling the governance structures of International Financial Institutions. To remain relevant and effective, these institutions need to adapt to the current global challenges, while broadening the voice, participation, and representation of developing countries. Additionally, Museveni called for measures to relieve poor countries of their debt burdens, stressing that many developing nations are struggling under unsustainable debt levels (Nile Post, 2024). Uganda has also been an advocate of change to the governance structures of the International Finance Institutions, whose rules it considers outdated and unfair. Uganda has also urged the Bretton Woods institutions to adapt the architecture to today's economic realities and power relations (Third South Summit Outcome Document, 2024).

Other critical areas of focus are debt relief and the cost of sovereign borrowing. The Ugandan government has expressed concern about the high debt levels of many countries, particularly in the global South. The government has advocated for measures to alleviate these debt burdens, which would free up resources for essential development projects. Uganda has also highlighted the need for more international public finance to support the Sustainable Development Goals (SDGs), noting that the global investment gap for financing the SDGs has widened.

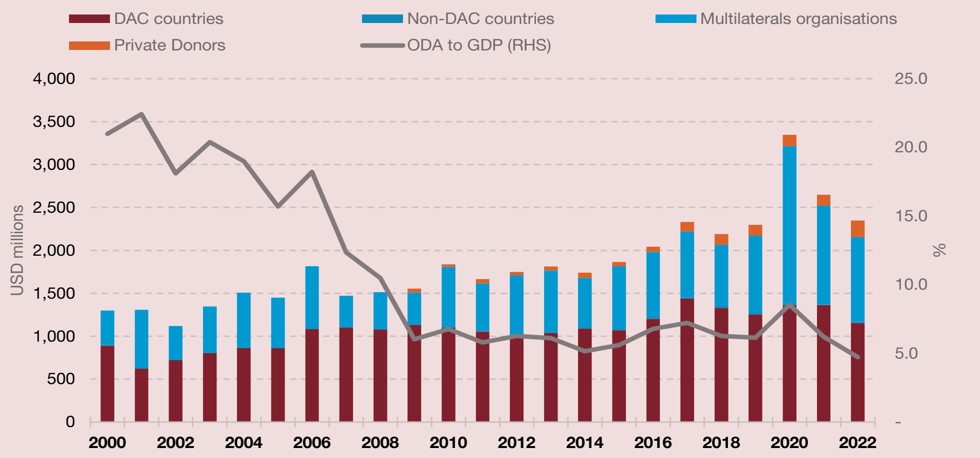
Uganda has pointed out that poorer countries in the global South are often excluded from the global financial safety net, lacking access to sufficient liquidity. Thus, Uganda has called for reforms to ensure

[2]For 2024, Uganda holds the Chairmanship of the G77

that these countries have better access to International Monetary Fund-issued Special Drawing Rights (SDRs). These proposals reflect Uganda's commitment to the creation of a more equitable and effective global financial system.

By implementing these reforms, Uganda stands to benefit significantly. Improved access to affordable credit and international finance would help fast-track structural transformation and sustainable development. Reforms in debt relief would provide much-needed fiscal space for investment in critical sectors like infrastructure, education, and healthcare, fostering long-term economic growth. Ultimately, a reformed global financial architecture would support Uganda's efforts to achieve its development goals and sustain its competitiveness in the global economy.

Figure 7: Uganda's Overseas Development Assistance by Partner Groups



Source: WDI

Figure 8: Uganda's Top External Financing Creditors, 2023 (USD Million)

Source: Ministry of Finance, Planning and Economics Development

Uganda maintains access to external financing through the global financial markets, borrowing from bilateral and multilateral agencies and commercial banks. In addition, Uganda receives considerable funding through grant aid from bilateral development partners and private sector funds and philanthropists. Official Development Assistance (ODA) to Uganda reached USD 2.2 billion in 2022, from USD 1.3 billion in 2000 (Figure 7). Nevertheless, ODA to Uganda declined quickly between 2000 and 2008 owing to the country's rapid economic growth expansion. ODA stayed largely flat, averaging 6.2 percent of GDP, between 2009 and 2020, when IMF and World Bank stepped up funding for COVID-19 relief, increasing disbursements to 8.5 percent of GDP. Since 2020, ODA has declined, to 4.7 percent of GDP in 2022. ODA to Uganda is largely on a ratio of 2:3 multilateral to bilateral finance, with private development aid growing in recent years.

Uganda benefits from GFA reforms as these will free up and mobilize more concessional finance, fast-tracking structural transformation.

Uganda's access to the global financial markets has mostly been through multilateral development banks, notably the World Bank and the African Development Bank (Figure 8), further supported by the IMF accounting for half of total credit. Bilateral creditors account for 27 percent mainly led by China Exim Bank and the UK Export Finance. Since 2016, when external financing through commercial borrowing was non-existent in Uganda, external borrowing on commercial terms has reached 13 percent of Uganda's total external financing. The rapid rise in commercial borrowing seems to demonstrate Uganda's liquidity needs—to close fiscal funding gaps and to invest in public infrastructure. The funding needs will continue to rise over the medium term to accelerate Uganda's structural transformation.

3.3 Mobilizing additional resources for Uganda's Structural Transformation

This section discusses the needed policy and regulatory reforms and how Uganda will benefit from these reforms in terms of trade, innovation and entrepreneurship, boosting investments in infrastructure, human capital, and technology to increase labor productivity. The section further highlights Uganda's experience with attracting external finances such as remittances, ODA, FDI and Private Investment.

Uganda has made progress in trade openness since the 1980s, when it signed regional and multilateral trade agreements and liberalized its trade regime. The country's trade openness, measured as the ratio of trade (exports and imports) to GDP, increased from 26.6 percent in 1990 to 34.5 percent in 2022. Structural transformation has benefited from trade openness as it has given Ugandan firms access to larger markets and has also increased access to inputs and technology upgrading production processes, enhancing competition and efficiency, and stimulating diversification. Increased openness has also exposed the economy to external shocks and vulnerabilities, such as terms of trade fluctuations, exchange rate volatility, and trade policy uncertainty.

Infrastructure development has been crucial for structural transformation by reducing production and distribution costs, improving quality, facilitating market connectivity, and enabling the adoption and diffusion of new technologies and innovations. Uganda has invested significantly in improving its infrastructure, particularly in the transport, electricity, and communication sectors. The road network increased from 21,000 km in 1990 to 159,366 km in 2022, with 4,500 km paved. Electricity generation capacity rose from 60 MW in 1990 to 1,378 MW in 2023, with 92 percent from renewable sources, mainly large hydropower systems. Mobile cellular subscriptions are estimated to have reached 64 percent of the population in 2023, and internet users 24 percent. Further structural transformation requires more effective and cost-efficient infrastructure, as well as lower transport costs for long-haul cargo and lower cost energy for industries with large power consumption.

Human capital development is critical, as it has contributed to increased labor productivity and employability, enhancing entrepreneurial and innovative capacities, and improving overall welfare and empowerment. Human capital development has been a priority for Uganda over the past three decades, especially in health and education. Life expectancy at birth increased from 46 years in 1990 to 64 years in 2023, and the infant mortality rate decreased from 107 per 1,000 live births to 31.2 per 1,000 live births. The adult literacy rate rose from 56 percent in 1991 to 81 percent in 2022, with youth literacy at 92 percent. Almost all children access primary school, while secondary has gross enrolment of 25 percent and tertiary has gross enrolment of 4.7 percent. However, for human capital related determinants of structural transformation to provide the full benefits, schooling and academic quality will have to improve.

Innovation in Uganda has improved, particularly in science, technology, and entrepreneurship. But research and development expenditure are still very limited and have declined from 0.37 percent of GDP in 2002 to 0.14 percent in 2014, with estimated 24 researchers per million population in 2014. Patent applications from residents grew from five in 2003 to 14 in 2021. New business density rose from 0.5 per 1,000 adults in 2006 to 0.9 in 2018, and the ease of doing business score improved, from 47.5 in 2010 to 60.2 in 2020. Innovation has been crucial for structural transformation, by generating new products, processes, and services, increasing competitiveness and value addition in existing sectors, and creating new sectors and opportunities.

Institutional quality has been essential for structural transformation, by providing a stable and predictable environment for economic activity, ensuring the protection and enforcement of property rights and contracts, and promoting public and private sector participation and accountability. Institutional quality has seen improvements, especially in governance, rule of law, and democracy. The political stability and absence of violence index improved, from 8.5 in 1996 to 17.5 in 2022, and the government effectiveness index improved from 27.3 to 31.1 (WGI, NA). The rule of law index rose from 32.7 to 39.2, and the control of corruption index deteriorated from 28.0 to 16.5. The voice and accountability index marginally improved, from 21.0 to 26.1, while the regulatory quality index deteriorated, from 53.8 in 1996 to 33.0 in 2022. According to the Mo Ibrahim index of African Governance, Uganda falls above the African The country's average for the foundations for economic opportunity is 54.2. As the indicators show, Uganda needs to implement reforms to improve the functioning of the government bureaucracy and reduce red tape and corruption.

To close the financing gap and fast-track structural transformation, Uganda has sought to attract external financing, including remittances, development aid, foreign direct investment (FDI), and public investment. Remittances have been a significant source of foreign exchange and household income. In 2023, remittances accounted for 2.6 percent of GDP. Development aid is another important source of finance, amounting to 4.7 percent of GDP, and has supported critical infrastructure and social projects. More recently, FDI has picked up with investments in oil, reaching 5.4 percent of GDP in investor inflows. FDI has brought capital, technology, and managerial expertise, and has supported public investment in key sectors like infrastructure, health, and education. By enhancing policy and regulatory frameworks to foster innovation and entrepreneurship, boosting investments in infrastructure, human capital, and technology, and effectively leveraging external finances, Uganda can accelerate its structural transformation and achieve sustainable economic growth. Uganda can continue to attract investors, by implementing investor-friendly reforms and strengthening its governance.

The inequitable distribution of global financial resources in favor of rich countries — countries that need them least — exacerbates Africa's plight, as evidenced by the USD 33 billion, or 4.5 percent of the USD 650 billion the continent received in Special Drawing Rights issued by the International Monetary Fund.

3.4 Dealing with Uganda's Debt

The challenges of raising external finance to fast-track structural transformation have been discussed, as well as the role public debt has played in financing development in Uganda. Challenges that Uganda faces in accessing debt in the context of debt sustainability have also been discussed. This section further attempts to identify gaps in the existing global financial architecture requiring reforms so that Uganda can access external resources at affordable credit terms to fast-track structural transformation.

Uganda faces several challenges in accessing external financing. Increasing levels of commercial borrowing expose the country to interest rate fluctuations and increase the cost of debt servicing. Additionally, the global financial environment has become more uncertain, with rising interest rates and volatile capital flows making it difficult for Uganda to secure affordable financing. These challenges underscore the need for policy and regulatory reforms to enhance innovation and entrepreneurship, boost investments in infrastructure, human capital, and technology, and increase labor productivity.

The role of public debt in Uganda is critical to the financing of development projects, especially large public infrastructure projects like roads and energy. But public domestic debt has also been critical in closing short-term funding gaps to fund health and education sectors. The growing reliance on commercial borrowing has raised concerns about debt sustainability and Uganda's ability to service its debts. To address these concerns, Uganda must implement sound fiscal policies and prioritize investments that yield high economic returns. Furthermore, strengthening public finance management systems will enhance transparency, accountability, and efficiency in public investments in the use of borrowed funds.
To better suit Uganda's financing needs and provide affordable credit terms, gaps in the global financial architecture need to be addressed. One major gap is the limited access to concessional financing. Uganda would benefit from reforms that increase the availability of low-interest loans with long tenures, as well as grants from international financial institutions. Although Uganda is not in any significant risk of debt distress, there is a need for more flexible debt rescheduling mechanisms that can provide short-term relief so as not to compromise long-term development goals.

Moreover, global financial institutions should enhance support for innovative financing mechanisms such as blended finance, which combines public and private resources to lower investment risks and attract more capital to development projects. Enhancing the issuance and allocation of Special Drawing Rights (SDRs) by the International Monetary Fund (IMF) can also provide much-needed liquidity to Uganda and other developing countries, helping them navigate economic shocks and sustain development efforts. Specifically for Uganda, there is merit in supporting low-cost long-tenor capital for green industrialization. A blended green industry financing facility could be a vehicle to support Uganda's acceleration of structural transformation by specifically focusing on industrial sectors.

Uganda's experience with attracting external finances has been mixed. Remittances have been a significant source of foreign exchange and household income, while development aid has supported critical infrastructure and social projects. FDI has brought capital, technology, and managerial expertise, and public investment in large infrastructure projects. The oil investments flowing to Uganda can help boost fiscal revenues, which, used wisely, can help accelerate structural transformation. A strategic approach to the use of these "extra" funds should be adopted to ensure best value for money. To fast-track its structural transformation, Uganda needs consistent access to external resources at affordable credit terms. By addressing the existing gaps in the global financial architecture and implementing domestic policy reforms, Uganda can leverage external financing to achieve sustainable economic growth and development.

Uganda's ability to achieve structural transformation centers on effectively managing its debt sustainability challenges, enhancing policy and regulatory frameworks to foster innovation and entrepreneurship, and increasing investments in infrastructure, human capital and technology. With comprehensive reforms at both the national and global levels, Uganda can secure the external financing needed to accelerate its economic development and improve the livelihoods of its citizens.

3.5 Financing Climate Action

This section highlights the impacts of climate change on Uganda's structural transformation. The section discusses socio-economic consequences of climate change and what Uganda is doing to mitigate climate change. Using the Bank's climate financing gaps for the country estimates, financing gaps and challenges are discussed in the context of the global financing architecture.

Insufficient resources, compounded by inadequate climate finance amidst escalating environmental threats, hinder Africa's growth and development agenda. Africa, which accounts for only 3 percent of global carbon emissions, suffers disproportionately from climate change. It currently faces substantial annual losses of between 5 percent and 15 percent of GDP. The Bank estimates Africa's climate finance gap at USD 1.6 trillion between 2022-2030 (AEO, 2022).

Climate change and green growth are critical issues for Uganda, as the country experiences warmer weather conditions and more extreme weather events such as volatile rainfall, flooding, landslides, and prolonged dry spells. Rapid population growth exacerbates these impacts, putting additional pressure on the environment and the economy. Safeguarding water resources and replenishing forests are essential parts of Uganda's adaptation strategy. Protecting large public and private infrastructure projects from climate impacts is also crucial to the longevity of public assets. Estimates show that the cost of climate inaction is significantly higher over the long term than what is required to adapt infrastructure and the economy. By 2025, the annual cost of inaction is projected to be between USD 3.1 billion and USD 5.9 billion, rising to between USD 18 billion and USD 27 billion by 2050, driven by unmet irrigation and biomass demand (CFR, 2023).

The socio-economic consequences of climate change in Uganda are severe, affecting agriculture, water supply, health, and overall economic stability. Agriculture, which employs a significant portion of the population, is highly susceptible to climate variability. Changes in rainfall patterns and increased frequency of extreme weather events lead to crop failures and reduced agricultural productivity, impacting food security and incomes. Water scarcity, exacerbated by prolonged dry spells and erratic rainfall, affects both rural and urban populations, leading to conflicts over water resources. Health issues also arise, as extreme weather conditions contribute to the spread of diseases such as malaria and cholera. These socio-economic impacts hinder Uganda's progress toward structural transformation and sustainable development.

Uganda has taken several steps to mitigate climate change. In 2023, the government launched the Nationally Determined Contributions (NDCs), which outline the country's commitments to reducing greenhouse gas emissions and adapting to climate impacts. The NDCs focus on key sectors such as agriculture, energy, forestry, and water. Uganda is also investing in renewable energy projects, promoting sustainable agricultural practices, and implementing reforestation programs. These initiatives aim to build resilience and reduce the country's carbon footprint, contributing to global efforts to combat climate change.

Despite these efforts, Uganda faces significant challenges in financing its climate action plans. According to the CFR (2023), the country will require "new and additional" finances to meet the growing costs of addressing climate change over the next decade, requiring between USD 37.4 billion and USD 43.6 billion. The report highlights a substantial financing gap, as the estimated cost of climate adaptation and mitigation far exceeds the current financing levels. This underscores the need for reforms in the global financial architecture to provide developing countries like Uganda better access to climate finance.

Multilateral development banks play a crucial role in addressing this financing gap. Reforms are needed to ensure that development banks can mobilize more resources for climate action, provide concessional financing, and support innovative financing mechanisms such as green bonds and blended finance. Additionally, enhancing the capacity of development banks to offer technical assistance and knowledge sharing can help Uganda design and implement effective climate strategies. By improving access to affordable and sustainable finance, Uganda can accelerate its structural transformation and build a more resilient and green economy.

3.6 Concluding Remarks and Policy Recommendations

Uganda would benefit from reforms in the global financial architecture, as these would help free up and mobilize more concessional finance to support its structural transformation and help to shift the balance from expensive commercial borrowing that has increased in recent years.

Short- to medium-term policy measures

Uganda should use its voice to promote continued reforms in the global financial architecture, in global fora and through the African Union.

Increasing development finance to improve the competitiveness of its production factors, like transport, energy, and raw materials, would accelerate structural transformation. The more than USD 2 billion Uganda receives annually from development partners is insufficient to address the public investment needs. Furthermore, just 5 percent of bilateral funding is directed towards education, and 10 percent to productive sectors, mainly agriculture. Uganda could tap into EU's Global Gateway or China's Belt and Road investment initiatives to upscale production factors.

Medium- to long-term policy measures

Stronger collaboration between international financial institutions to leverage finance from the domestic financial sector is required to increase risk capital for investment, through blended finance and other credit enhancements to support development of domestic manufacturing, formal mining, and construction.

Uganda's progress towards structural transformation is significantly impacted by climate change. The socio-economic consequences are far-reaching, affecting agriculture, water resources, health, and overall economic stability. While the country has made efforts to mitigate climate change, the financing gap remains a major challenge. Bridging this gap requires reforms in the global financial architecture, enhanced support from multilateral development banks, and bilateral development partners. Along with the rest of Africa, **Uganda should therefore continue to appeal for increased financial resources to support effective climate strategies, to achieve sustainable development and build resilience against future climate challenges.**

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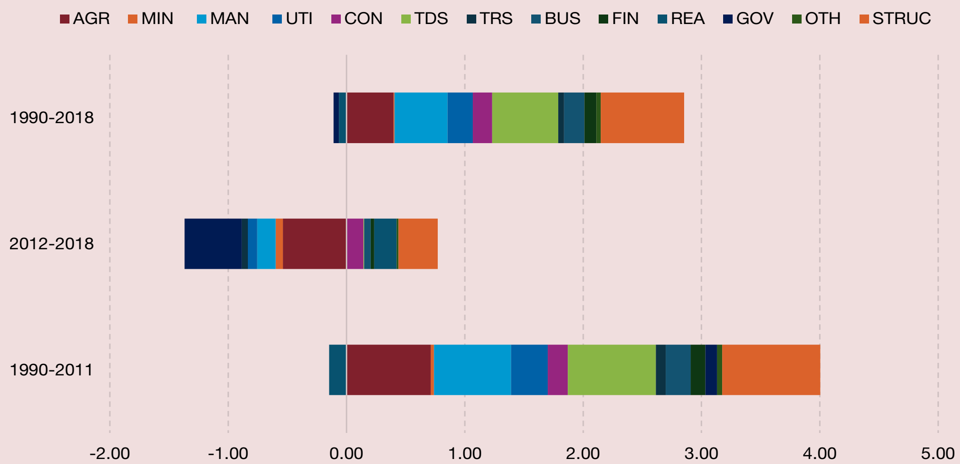
Annex 1: Shift in Sectoral Productivity and Employment Share

Figure A1-9: Correlation Between Sectoral Productivity and Change in Employment Shares in Uganda (2011 - 2018)

Note: The size of the circle shows the relative size of employment in each sector in 1990. AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. Source: ETD.

Annex 2: Labor Productivity, Sectors and Structural Shift

Figure A2-10: Labor productivity from within the sectors and from structural change (12 sectors)



Note: AGR, agriculture; MIN, mining; MAN, manufacturing; UTI, utilities; CON, construction; TRD, trading services; TRS, transport services; BUS, business services; FIN, financial services; REA, real estate services; GOV, government services; OTH, personal services. STRUC, structural change. Source: ETD.

Annex 3: Uganda's External Borrowing

Table A3-5: Uganda's external debt, various institutions, USD millions, 2023

DEVELOPMENT PARTNER (USD million)	DISBURSED AMOUNT	UNDISBURSED AMOUNT	TOTAL OUTSTANDING AMOUNT INCLUDING ARREARS
Grand Total	**17,157.9**	**3,788.5**	**14,639.1**
BILATERAL	4,558.2	1,040.1	3,564.8
ABU DHABI FUND	10.9	0.1	10.2
AFD	315.5	254.3	263.3
EXIM BANK OF CHINA	3,211.9	264.7	2,510.6
EXIM BANK OF INDIA	6.0	24.0	6.0
EXIM BANK S. KOREA	24.4	2.0	21.8
GOVT OF NIGERIA	9.0	0.0	11.5
IRAQ FUND	0.0	0.0	0.0
JBIC	109.5	0.0	26.8
JICA	236.3	175.4	213.8
KFW	29.7	69.9	23.3
KUWAIT FUND	64.8	12.4	43.6
MOF AUSTRIA	21.7	0.0	0.0
SAUDI ARABIA FUND	46.7	1.4	34.9
SPAIN	30.8	18.6	30.0
UKEF	440.9	207.2	369.0
COMMERCIAL BANKS	2,215.5	26.5	1,873.6
AFREXIM	387.4	0.0	387.4
AKA	11.7	0.3	8.3
Bank of Austria	3.5	4.8	3.5
COMMERZBANK	14.2	20.8	10.2
SBSA	885.4	0.0	785.8
STANDARD CHARTERED	359.9	0.6	286.0
TDB (PTA)	553.4	0.0	392.4
MULTILATERAL	10,384.1	2,721.9	9,200.7
ADB	381.6	619.1	338.8
ADF	1,677.3	263.3	1,607.7
BADEA	76.6	17.9	65.9
EIB	204.8	0.0	106.4
IDA	5,387.0	955.7	4,667.5
IDB	665.5	393.4	611.3
IFAD	362.3	160.1	254.8
IMF	1,455.8	242.2	1,450.4
NDF	66.2	0.0	41.0
OPEC FUND	107.1	70.1	57.0

Source: Ministry of Finance, Planning and Economic Development.

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