



International
Labour
Office
Geneva

**Employment Sector
Employment Working Paper No. 91**

2011

**Macroeconomic policy for “full and
productive employment and decent
work for all”:
Uganda country study**

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Employment
Policy
Department

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First published 2011

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ILO Cataloguing in Publication Data

van Waeyenberge, Elisa; Bargawi, Hannah

Macroeconomic policy for "full and productive employment and decent work for all" : Uganda country study / Elisa van Waeyenberge, Hannah Bargawi ; International Labour Office, Employment Sector, Employment Policy Dept. - Geneva: ILO, 2011
1 v. (Employment working paper; No.91)

ISBN: 978-92-2-125400-3 (print pdf); 978-92-2-125401-0 (web pdf)
ISSN 1999-2939 (print); 1999-2947 (online)

International Labour Office; Employment Policy Department

full employment / decent work / poverty alleviation / structural change / labour policy / economic policy / Uganda

13.01.3

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Printed by the International Labour Office, Geneva, Switzerland

Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization, and*¹ which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work², in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.³

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.⁴

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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¹ See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

² See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

³ See <http://www.ilo.org/gea>. And in particular: *Implementing the Global Employment Agenda: Employment strategies in support of decent work*, "Vision" document, ILO, 2006.

⁴ See <http://www.ilo.org/employment>.

Foreword

At the 99th session of the International Labour Conference, constituents endorsed the need to promote a ‘pro-employment’ macroeconomic framework. It was felt that the current framework, while making an important contribution to the goal of macroeconomic stability, paid insufficient attention to the way in which macroeconomic policy instruments either helped or hindered employment creation and poverty reduction. In the standard framework that has evolved since the days of the structural adjustment programmes of the 1980s and 1990s and that has remained intact during the 2000s, the emphasis is on attaining key nominal targets pertaining to debts, deficits and inflation. The rationale is that attaining such targets in the medium to long run will engender a predictable macroeconomic environment that is crucial for supporting growth and hence employment creation. It now appears that macroeconomic stability is necessary, but by no means sufficient to engender inclusive, job-rich growth.

The ILO/Korea partnership programme has been providing additional support to the Employment Policy Department’s endeavour to identify existing constraints in the macroeconomic policy instruments that may hinder generation of full and productive employment, and to suggest a way forward for job-rich growth. A series of country case studies has been conducted, and the current case study of Uganda represents one result. It analyzes recent macroeconomic performance, shows their relationship with employment outcomes or lack thereof, reviews the existing programmes on employment and social safety nets, and reflects the views of the ILO constituency and other key national stakeholders that were collected through consultations.

The paper shows that the Ugandan high rate of economic growth in the 2000s was accompanied by important reductions in poverty and structural transformation of the economy. Yet, agriculture employs a high and rising proportion of the labour force, despite its falling share in GDP, and the share of employment in manufacturing sector declined during the first half of the 2000s. The paper reviews the existing policy framework, including the 2010-2014 National Development Plan, and assesses the extent to which macroeconomic policy stance, which has been largely concerned with price stability since the early 1990s, supports the achievement of the Plan’s objectives. The current financial commitment to the Plan remains uncertain, where a host of important projects depend on the private sector for funds. It suggests some alternative policy options for prudently re-orienting the macroeconomic policy framework in the areas of fiscal policy, monetary policy, exchange rate policy, and capital account management. The paper argues that new policy directions at the macro level are necessary but in themselves insufficient. There is a need to put in place complementary structural policies, including specific sectoral and labour market policies.

The paper was presented and discussed at a national workshop in November 2010, opened by the Hon. Minister of Gender, Labour and Social Development, Prof. G. Opio along with the representatives of the Employers’ and Workers’ organizations. The paper reflects the valuable and concrete views that were actively expressed by the participants. We are grateful to the ILO Country Office for the United Republic of Tanzania, Kenya, Rwanda and Uganda for providing valuable support in organizing and conducting the workshop.

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1. Introduction

Since the “Great Recession”, a two-fold challenge has confronted many low-income countries. First, they had to find ways to curb and counteract the fall in domestic demand in their economies; and, second, they had to continue laying the basis for a more secure and sustainable path of growth, development and poverty reduction through structural transformation and diversification of their economies. Indeed, despite relatively high growth rates in a number of low-income countries in the period preceding the onset of the combined food, fuel and global financial crises, these economies often remain characterised by poorly developed productive capacities and insufficient diversification into activities that can absorb fast-growing populations into productive employment. Often, low-income countries have remained excessively dependent on agro-commodity or low-tech manufacturing exports and remain vulnerable to volatile external markets (see UNCTAD 2008). As argued in the *2009 Least Developed Countries Report* (UNCTAD 2009, p. 148):

Unless growth is accompanied by a continuous increase in productivity and a stable or rising employment–population ratio, growth is not likely to be sustainable. Structural change is therefore a quintessential condition for dynamic and sustainable growth, characterized by higher productivity and increasing returns to scale. More importantly, the current global crisis reveals how crucial structural change and economic diversification can be in reducing LDC vulnerability to external shocks.

The terms of reference for the current study refer to the “paradox of macroeconomic stability”, which suggests that the record of macroeconomic stability in developing countries neither yielded the growth dividends that were expected, nor did it bring about the necessary structural changes for sustainable and productive employment creation.

Yet, apart from highlighting the necessity for a fundamental change of direction in economic policy in the poorer countries, the current historical circumstances may also have created an opportunity for a redefinition of the development agenda, as the global economic and financial crisis throws old certainties into disarray. Indeed, through its dramatic effects in the real economy and the responses these elicited, the global financial crisis has cast a critical shadow over the model of development and growth that has been so heavily promoted over the last three decades. Across countries in the industrialised world, governments intervened with enormous rescue packages for the financial sector, initiated countercyclical policies of various kinds, and provided comprehensive guarantee programmes for the banking industry, policies previously abhorred in the North – at least officially, before reverting dramatically to austerity as the overarching imperative.

Within this context, opportunities may have arisen to redefine a now much-discredited policy order. Grabel (2010) refers to the emergence of a form of “productive incoherence”, which may have created the possibility for departures from the traditional policy prescriptions often promoted by the Bretton Woods Institutions.⁵ Hence, charting clear alternatives both in general terms and for specific country-settings becomes an imperative task.

⁵ Grabel (2010, p. 2) refers to the “inconsistency and even contradictions in crisis response as productive incoherence ... the new incoherence may signal a new openness to policy and institutional innovation or, at the very least, a temporary aperture born of uncertainty about the lessons of the current crisis. In that sense, what I see as an incoherent response to the current crisis may ultimately prove to be productive of development and supportive of policy and institutional diversity in vital ways”.

A new agenda needs to re-situate macroeconomic policy so that it becomes centrally focused on the urgent priority of upgrading low-income countries' productive capacity, with particular attention to rapid productivity increases in the agricultural sector accompanied by an expansion and diversification of the manufacturing sector.

Crucially, the macroeconomic context of fiscal, monetary, exchange rate and capital account policies should not impose a straightjacket on the broader set of policies that are necessary to enable faster upgrading of a country's productive capacity (accompanied by effective absorption of a fast-growing labour force). Inherent contradictions between the set of policies that have traditionally been associated with the Bretton Woods Institutions, including low inflation rates, budgetary stringency, trade openness, liberalisation of the domestic economy etc., and policies (both at the sectoral and national level) that seek to foster the upgrading and diversification of the economy, need to be made explicit and creative ways forward need to be charted to enable the latter.

In other words, the macroeconomic realm can no longer be treated in isolation from the development trajectory of a particular country. It is time to reconsider how macroeconomic policies affect, and are themselves affected by, policies that seek to enhance productivity in the economy and foster structural change. This goes beyond marginal adjustments to previous targets and includes a thorough rethinking of the linkages between various macroeconomic policy stances and specific sectoral policies aimed at upgrading productive capacity across the economy.

Such a direction in macroeconomic policy design can draw on important existing work that has sought to provide alternative frameworks, for instance through linking macroeconomic policies to the Millennium Development Goal (MDG) framework and re-instating public investment at the centre of macroeconomic policy (see for instance Heintz and Pollin 2008; Weeks and McKinley 2007; Pollin, Epstein and Heintz 2008). Moreover, specific sectoral strategies of agricultural and industrial upgrading and diversification should drive development policy, with macroeconomic policy directions assisting in their attainment (see UNCTAD 2009).

Further, the employment and "decent work for all" agenda need to be put at the centre of macroeconomic policies. This necessitates a better acknowledgement of how "labour market outcomes depend on the level of investment in real productive capacity" (UNCTAD 2010, p. 78), which is itself is crucially affected by public investment (and targeted sectoral interventions). Indeed, it was recently argued in the *2010 Trade and Development Report* (UNCTAD 2010, p. 79) that: "unsatisfactory labour market outcomes are more likely to be due to insufficient investment in real productive capacity and inadequate wage growth than to insufficient 'flexibility' in labour markets and the replacement of labour by capital." The Report highlighted that "macroeconomic conditions favourable to fixed capital formation and the full participation of labour in the productivity gains emerging from innovative investment are necessary for achieving and maintaining a high level of decent employment, irrespective of the stage of development of an economy". There is hence an urgent need for a "reassignment of macroeconomic policies for employment creation" (p. 145).

This study seeks to explore these various issues in the context of the Ugandan economy, where the "full and productive employment and decent work for all" agenda has been hampered by insufficient structural diversification and upgrading of the economy, in conjunction with weak labour market institutions. This has occurred despite (or because of?) strict adherence by the Ugandan government to the various prescriptions of the Bretton Woods Institutions, including tight monetary and fiscal policies, a flexible exchange rate, an open capital account, and extensive deregulation and privatisation efforts.

A major argument pursued here then points to the insufficiency of a strategy that relies predominantly on the private sector to generate accumulation patterns that engender and sustain structural transformation of the economy towards higher productivity activities and better employment opportunities and conditions. Recently, there have been apparent changes in Uganda's strategic direction. These are emblematic in the strong rhetoric on a revitalisation of the role of the government in the Ugandan economy, mainly through an emphasis on infrastructure provisioning (in particular transport, power and irrigation). This reorientation of Uganda's priorities is to be welcomed.

Despite the clear need for such a shift in direction, the Ugandan government's current *financial* commitment to these priority areas, however, remains uncertain. A potential shortfall in funding would jeopardise the ability of the Ugandan authorities to undertake the proposed large-scale investment programmes and hamper the beneficial implications of these for the expansion of productive employment and improve working conditions. This paper argues that, overall, the scope for a fundamental change in policy direction remains circumscribed by the continuing commitment on behalf of the Government of Uganda to an orthodox macroeconomic framework concerned with price stability, low deficits, flexible exchange rates and external openness. One of the purposes of the current report is to tease out the way in which the government's macroeconomic framework conditions the scope for the diversification and upgrading of the economy in line with the proclaimed aims of the recent National Development Plan (Republic of Uganda 2010).

Further, a focus on increasing investment alone is insufficient, as a host of complementary measures are necessary to ensure that increases in investment translate in improved employment patterns. In particular, the agricultural sector has suffered from severely inadequate and declining budgetary allocations despite its crucial role in the Ugandan economy and its very poor and worsening performance. And various labour and employment issues remain to be addressed.

Our study proceeds as follows. Section 2 maps the Ugandan economy, paying particular attention to poverty and employment matters. This is followed, in Section 3 by a critical dissection of the failures of the Ugandan economy in terms of structural diversification. Section 4 follows with a brief account of the challenges the Ugandan economy faces, setting out the analytical principles that guide the assessment in the subsequent sections. Section 5 provides an overview of the National Development Plan and how it seeks to overcome some of the most binding constraints operating on the Ugandan economy. Section 6 undertakes a close dissection of the trends that have characterised macroeconomic policy. This is done across the four areas of fiscal policy, monetary policy, the exchange rate and the capital account. In each section, suggestions are made for alternative policies. The study concludes, in Section 7, by highlighting the need to go beyond a focus on macroeconomic policies for the necessary diversification and upgrading of the Ugandan economy to take place. This would assist in making the "full and productive employment and decent work for all" agenda materialise.

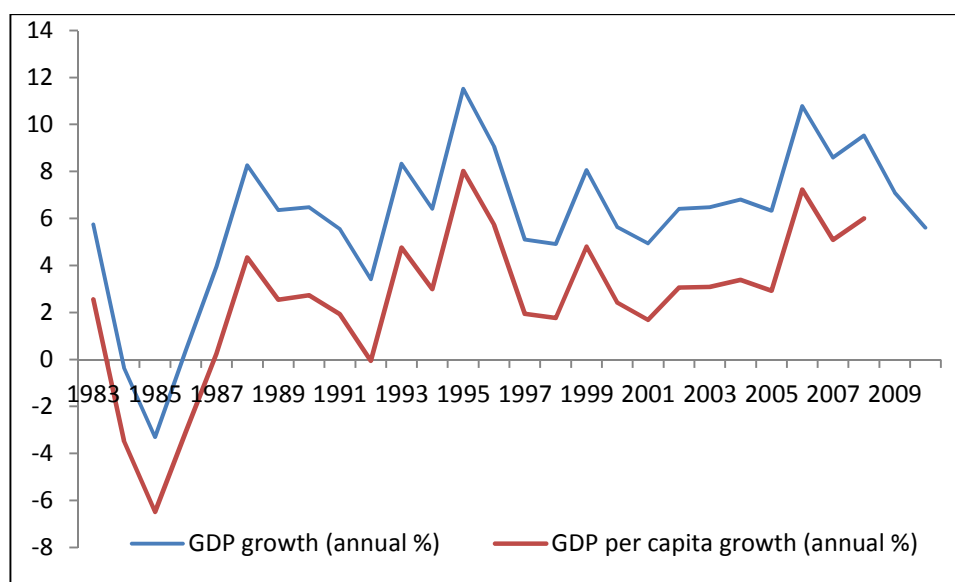
This paper was written on the basis of extensive consultation of a host of documents, including from the Government of Uganda, various line ministries, donor documents and academic writings. This was complemented with information gathered through interviews. These interviews were held in Kampala in September and October 2010. The appendix provides a list of institutions and stakeholders consulted.

2. Growth, poverty reduction and employment in Uganda

2.1 Growth and sectoral change

For the last two decades, the Ugandan economy has recorded substantial GDP growth rates (see figure 1). These reached an average of 6.9 per cent between 1987 and 1996, translating into a 3.3 per cent per capita growth rate. This decreased slightly to an average annual growth rate of 5.7 per cent for the period between 1998 and 2001 (equivalent to 2.5 per cent in per capita terms). Since 2002 growth rates have been on the increase. Over the period 2002-2005 average annual GDP growth rates were 6.5 per cent (or 3.1 in per capita terms) and have increased further to an impressive 9.6 per cent on average in the last three years preceding the food, fuel and financial crisis (2006-2008) (Republic of Uganda 2010, p. 1; World Bank, World Development Indicators). During 2008/9 the Ugandan economy grew at a rate of 7.1 per cent. This was below the government's target of 8.5 per cent, with the divergence having been ascribed to the effects of the global financial crisis (see Ssewanyana and Bategeka 2010).

Figure 1. GDP annual rates of growth; per capita GDP growth, 1983 – 2008

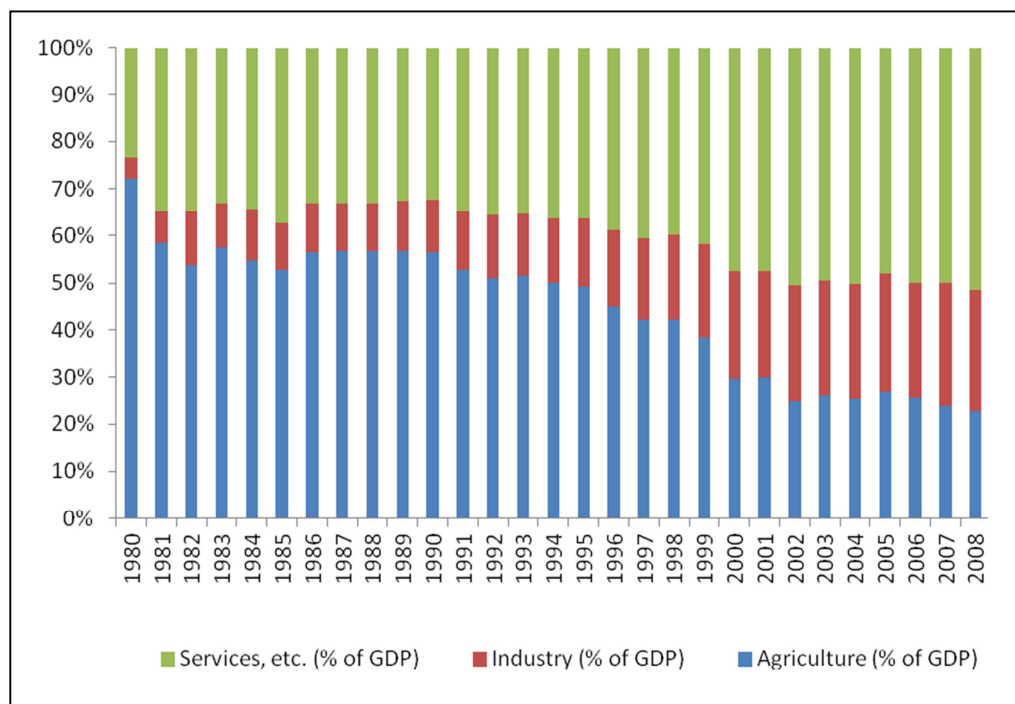


Source: World Bank, World Development Indicators.

The growth of the economy has been accompanied by a changing sectoral distribution of GDP. Figure 2 illustrates how services have come to account for the major part of economic activities in Uganda (accounting in 2008 for over 50 per cent of GDP).⁶ The agricultural sector has seen the largest decline as a share of GDP. While this sector contributed over 70 per cent to GDP in 1980, this has declined to barely 20 per cent in 2008. The industrial sector, including mining, construction and manufacturing, has seen an increase in its share of GDP from an average of 10 per cent in the 1980s to an average of 25 per cent in the 2000s. Within the industrial sector, the construction sector's share has increased significantly, from just over 4 per cent in the late 1980s to just over 12 per cent in 2008. This is in contrast to a rather stagnant share of the manufacturing sector (see also Section 3 below). Overall, growth of the Ugandan economy has been driven mainly by the service sector, including the hospitality, trade and communications sub-sectors.

⁶ Growth in the service sector has been dominated by telecommunications, the hospitality industry (hotels), and trade.

Figure 2. Trends in the sectoral composition of GDP, 1980 - 2008



Source: World Bank, World Development Indicators.

This changing sectoral distribution of GDP has not been matched by a commensurate change in the distribution pattern of the labour force, as the agricultural sector continues to dominate employment. Significantly, Uganda’s pattern of growth has not been characterised by a change in the structure of employment towards manufacturing, with the share of this sector in total employment stagnating, and recently declining, despite growth of output. Islam (2004, p. 16) argues how this “raises an important question about the sustainability of the present rate of poverty reduction in Uganda.”

Successful patterns of structural change feature a virtuous self-reinforcing cycle of industrialisation, with industrialisation fostering productivity growth (through economies of scale), higher incomes, growing investment and domestic demand, fostering further industrialisation. This cycle depends on organic links between industry and agriculture, mainly in terms of supply/demand of labour and wage goods (including foodstuffs and manufactured goods). Depending on the nature of the integration of the economy in the global patterns of trade and production, the traditional links between agriculture and industry can, however, be weakened, as, for instance, an urban population can be fed on imported food and the demand for manufactured goods can be met through imports rather than expanded domestic production. A recent UNRISD Report (2010, p. 33) draws attention to the reality that different trajectories of structural transformation are observed in many countries today:

Movement out of agriculture is still occurring, but the resulting labour force is not automatically absorbed into the industrial sector. Instead, workers move disproportionately into the service sector and informal employment, where the scope for sustained growth in productivity and improvements in incomes is limited.

This raises important issues for the prospects regarding sustained increases in standards of living and is a recurring theme throughout the paper.

2.2 Poverty reduction

The growth performance of the Ugandan economy has been accompanied by important reductions in poverty levels. The share of the population living below the poverty line declined from 56 per cent in 1992/3 to 31 per cent in 2005/6 (Republic of Uganda 2010, p. 1). Most recent data indicate a further decline to 25 per cent (UBOS 2010, p. 75).

Inequality of income, however, increased by nearly 12 per cent during the period spanning 1992/3 and 2005/6 as the Gini coefficient increased from 0.37 in 1992 to 0.41 in 2005/6 (UBOS 2006, p. 67).⁷ This has further worsened more recently, with the Gini coefficient in 2009/10 standing at 0.43 (UBOS 2010, p. 85). UBOS (2010, p. 92) sums up as follows:

While the proportion of people living in poverty significantly declined, the reduction in number of poor persons – in absolute terms – was not significant; and inequality of income worsened. In other words, while Uganda seems to have met the MDG 1 target of halving income poverty earlier than 2015, worsening distribution of income and high population growth if not addressed might reverse the trends.

Inequality in consumption remains high and is characterised by regional disparities, with the mean consumption of the richest area (Kampala) being 2.5 times higher than that of the poorest (Northern) region (Republic of Uganda 2010, p. 14). Nearly 61 per cent of the population in northern Uganda lived in poverty in 2005/6, although this declined to 46 per cent most recently (UBOS 2010, p. 81). Across the country, the incidence of poverty remains higher in rural than in urban areas: the poor in the rural areas represent just over 27 per cent of the population, but only 9 per cent in urban areas (UBOS 2010, p. 74). While the financial crisis may not have been a major concern regarding poverty, the preceding food and fuel crises, however, are understood to have hit the poor hard (see Sender and von Uexkull 2009).⁸

Ssewanyana and Younger (2007) also observe that rapid growth rates have not always translated into improvements of other indicators of well-being, such as infant and child mortality rates, in Uganda. For example, Uganda's under-five mortality rate was 144 deaths per 1000 live births in 2006, having reduced only marginally over the previous decade. The equivalent rate in 1995 was 156 deaths per 1000 live births (Macro International Inc., 2009 Demographic and Health Surveys).

Unfortunately, data on human development indicators are not collected on an annual basis, making an analysis of the impacts of the food, fuel and financial crises on these aspects difficult. A recent UNDP Report (UNDP 2010, p. 72) on Uganda's progress towards the MDGs concludes that while progress in some areas has been made, "(i)n other areas however, progress has been slow, and in a few cases, there has been reversal with the situation outright deteriorating". For example, while access to primary education has improved, the rates of completion have stagnated in recent years. Similarly, targets relating to child mortality, maternal mortality, access to reproductive health, and the incidence of malaria have also progressed too slowly for the national and

⁷ If pro-poor growth is conceptualised in terms of the share of the poor in the additional output produced, then growth can only be characterised as pro-poor when the distribution of income improves. When the income of the poor increases while the distribution of income worsens, the poverty reducing effect of economic growth is diminished (see Islam 2004).

⁸ It is difficult, as yet, to obtain accurate information regarding changes to poverty levels, depth and persistence in Uganda following the recent global crises (see Ssewanyana and Bategeka 2010).

international targets to be realised. Furthermore, the Report also reveals a great deal of unevenness between different population groups and between different geographical areas of the country in terms of progress achieved.⁹

2.3 Employment

The extent to which growth reduces poverty depends on a variety of factors characterising the pattern of growth (see Islam 2004). One important factor is the degree of the employment intensity of the growth process. The other is the ability of the poor to benefit from the employment opportunities that are created (p. 11). As Epstein and Heintz (2006, p. 7) observe:

Improving the quality and quantity of employment opportunities directly links economic growth to poverty reduction. Low-income households possess few assets of their own. Instead, the most abundant resource the poor have at their disposal is their labour. Therefore, a development strategy that more fully employs a country's human resources and raises the returns to labour becomes an effective instrument for reducing poverty.

The Uganda National Employment Policy concurs with the view that inadequate productive employment opportunities perpetuate poverty. It adds that (p. 2):

To the poor, most of whom have not completed primary school and face difficulties in acquiring productive assets such as land and credit, access to wage employment opportunities is the only means of escaping poverty. The Uganda Participatory Poverty Assessment Programme 2003 confirmed that poverty was characterised by lack of access to wage employment opportunities, low wages for those who were employed and insecure incomes for those in self-employment.

The Ugandan economy faces the particular challenge of needing to absorb 392,000 new entrants into the labour market each year (Ministry of Gender, Labour and Social Development 2010, p. 2). According to estimates, labour force growth in 2005/6 stood at 3.6 per cent per annum, higher than the population growth rate of 3.2 per cent (UBOS 2006, p. 26). This is compounded by a high growth rate of the youth labour force, which stood at 5.7 per cent per annum in 2005/6. The latest data, released in the Uganda National Household Survey 2009/2010 (UBOS 2010) indicate that labour force growth has further accelerated to reach an annual rate of 4.7 per cent. The employment to population ratio (defined as total employment of the population aged 14-64 years as a percentage of the total population in the same age group) is, however, estimated to have increased from nearly 70 per cent in 2005/6 to about 75 per cent in 2009/10 (UBOS 2010, p. 35).

Yet, 85 per cent of the labour force remains rural (82 per cent in 2009/10). Approximately 17 per cent of the labour force does not have any formal education, while only just half of the labour force has primary education (53 per cent, down from 59 per cent in 2005/6) (UBOS 2010, p. 32). Many Ugandans are employed in low-productivity economic activities. And while the official estimate of the unemployment rate stood only at 1.9 per cent in 2005/6 (compared to 3.5 per cent in 2002/3), underemployment was estimated at 12 per cent for the same period (UBOS 2006, p. 40).^{10 11} For 2009/10,

⁹ See also ODI (2010) for a progress report on Uganda and the MDGs.

¹⁰ A person is classified as time-underemployed if s/he has worked less than 40 hours a week and is willing and available to work more hours.

¹¹ Note that in the 2010-2014 National Development Plan, unemployment (including underemployment) is reported at 29.1 per cent for 2005/6 (Government of Uganda 2010, April version, paragraph 182).

unemployment was estimated at 4.2 per cent (UBOS 2010, p. 44), while (time-related) underemployment seems to have declined to 3.5 per cent (p. 45).

UBOS (2006) indicates that a very high and rising percentage of the labour force (70 per cent) is self-employed or employed as unpaid family workers in the agricultural sector.¹² Self-employment outside of agriculture has declined from 22.3 per cent to 13.4 between 2002/3 and 2005/6.

Overall, self-employment in the economy still accounts for nearly 85 per cent of the working population. Only 15 per cent of the workforce is employed for wages, with only 4.6 per cent as permanent employees and 11.6 per cent as temporary employees (UBOS 2006, p. 29).¹³

The very high proportion of self-employed persons in the economy is an indication of low growth in the formal economy and a high rate of job creation in the informal economy. UBOS (2006, p. 29) adds that “a situation where a large proportion of the employed is constituted by unpaid family workers is a probable indicator of poor development, limited job creation, widespread poverty and often a large rural economy”.

Agriculture remains the major sector of employment, with its share increasing from 66 per cent in 2002/3 to 73 per cent in 2005/6, i.e. agriculture employs a high and rising proportion of the economically active population (and absorbs about 40 per cent of annual growth in labour force) – despite its falling share in GDP.¹⁴ The share of the labour force engaged in the manufacturing sector declined from 7.7 per cent to 4.2 per cent over the same period, and the share of the labour force employed in the services sector declined from 26.3 per cent to 22.8 per cent.¹⁵

Apart from the agricultural sector, small-scale unregistered non-farm enterprises are the second highest provider of employment opportunities. Many enterprises in the informal sector are characterised by low labour productivity, use of basic technology, limited access to credit and finance, difficulties in obtaining raw materials and other inputs, as well as inadequate markets for semi-processed products (Ministry of Gender,

¹² “The self-employed include employers, who could create jobs for others; own account workers and unpaid family workers who assist in the household enterprises” (UBOS 2006, p. 29).

¹³ The National Employment Policy, however, notes that this low figure for wage employment is misleading as the Household Surveys provide insufficient information on participation in seasonal and casual wage employment by rural household members. For almost all members of these households, the “primary” or main employment activity is defined as self-employment or unpaid family work as farmers, but little information is collected concerning the other forms of employment that are combined with farming in order to survive (Ministry of Gender, Labour and Social Development 2010, p. 4).

¹⁴ Yet the National Employment Policy again observes (Ministry of Gender, Labour and Social Development 2010, p. 7) that the labour force employed in agriculture spends on average *only* 23 per cent of their work time on agricultural activities. The low productivity of many of these intermittently pursued activities is reflected in the high rate and concentration of household poverty in rural areas. Employment opportunities in high value agricultural export commodity production such as floriculture, tea, coffee, tobacco, cotton and in the production of exported fish have grown very slowly, because production volume of these commodities has been stagnant for many years. The growth of crop yields per hectare have also been sluggish indicating a slow rate of growth of labour productivity reflected in extremely low levels of pay for workers producing agricultural commodities (see Sender and von Uexkull 2009).

¹⁵ The new data generated by the latest National Household Survey portray a slightly different picture, where the share of agriculture in employment has fallen to 66 per cent in 2009/10, the share of services increased to 28 per cent, and the share of manufacturing stands at 6 per cent (UBOS 2010, p. 38).

Labour and Social Development 2010, p. 6). The annual average growth of government wage employment over the period 1992-2005 was negative (-0.6 per cent). The wage bill for the public sector in Uganda accounts for a smaller percentage of GDP than in many other African countries and the percentage has been declining since 2002 (Ministry of Gender, Labour and Social Development 2010, p. 5).

According to the Labour Market Conditions in Uganda 2007 (quoted in Ministry of Gender, Labour and Social Development 2010, p. 5), as many as 30 per cent of the employees in the private sector earn less than US\$20,000 per month (approximately US\$12). The lowest wages are received by female workers, especially female domestic servants and agricultural wage workers. This implies that many workers' incomes cannot satisfy their basic needs. According to the Report on Labour Market Conditions in Uganda 2007, the working poor represented 28.6 per cent of the total population in 2005/6 (Ministry of Gender, Labour and Social Development 2010, p. 2). Further, few low-paid private sector employees have been able to increase their money wages in the period since 2007, despite sharp increases in the prices of basic foods over 2008-2009. This has resulted in sharp declines in real wages for groups of vulnerable employees (see Sender and von Uexkull 2009).

Labour productivity in Uganda also remains very low. The National Development Plan reports that the value added per worker in Uganda is 68 per cent lower than that in India and 96 per cent lower than that in China. Tanzania's labour productivity is 28 per cent higher than that of Uganda (Republic of Uganda, 2010, April version, p. 219).

The agricultural sector suffers from particularly low and worsening productivity levels (Republic of Uganda 2010). The National Development Plan emphasises that "the agriculture sector therefore requires a strong stimulus if it is to absorb the increasingly large number of the labour force. Alternatively, other sectors of the economy (industry and services) will have to expand significantly in order to create opportunities for labour migration from the agricultural sector" (Republic of Uganda, 2010, April version, p. 205).

As such, despite the reasonable growth performance of the Ugandan economy, employment remains dominated by low-productivity activities, mainly as self-employed or unpaid family workers in the agricultural sector. Permanent wage employment exists only for a small fraction of the labour force. Precarious forms of employment have grown and provide the bulk of employment opportunities, and many workers struggle to meet their basic needs with their incomes. Further, Sender and von Uexkull (2009) highlight how low-wage casual workers have been particularly hit by the combination of the food, fuel and financial crises, as their real wages declined steeply due to a combination of food price inflation and stagnation of nominal wages. Uganda then faces the particular challenge of generating improved employment opportunities and working conditions to overcome the prevailing informal and precarious employment conditions, so that poverty can be reduced further in a sustainable manner across the economy.

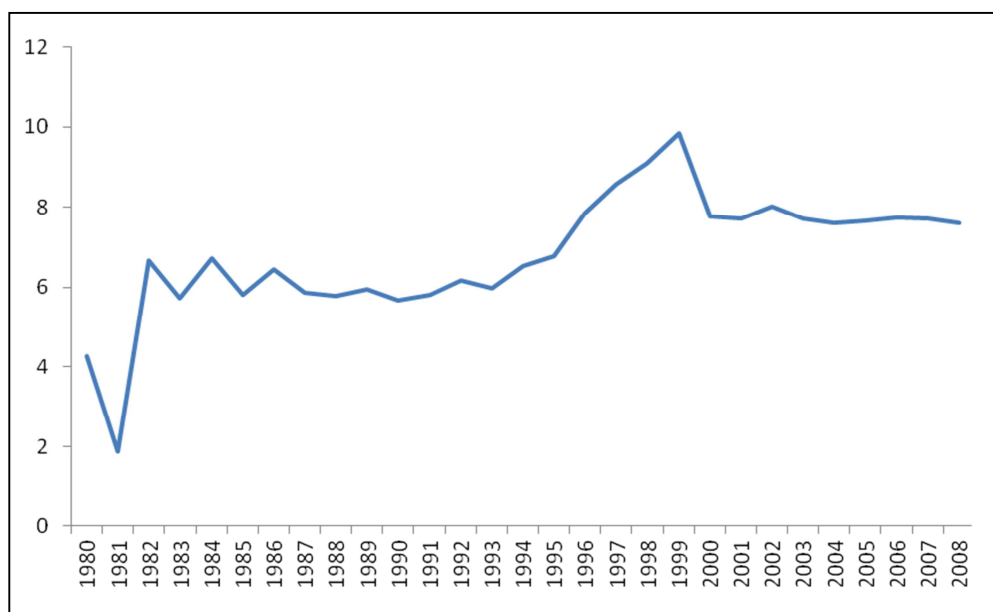
3. Realities of structural transformation in Uganda

The section above illustrated that the high growth rates characterising the Ugandan economy have not allowed for an effective absorption of a fast-growing labour force into productive activities. This section documents how the socio-economic transformation needed to ensure such an outcome seems to be occurring at a very slow pace in Uganda – if at all.

Crucially, growth in agriculture, the sector from which the majority of the population derives its livelihood, has been very weak in the last decade. Having averaged 5.4 per cent per annum during the period between 1998 and 2002, growth in the agricultural sector slowed dramatically to an average of 1.1 per cent per annum between 2004 and 2008 (Republic of Uganda, 2010 April version, table 2.3). Productivity growth in agriculture also has been very weak and there are indications that rural poverty is increasing (Joughin and Kjaer 2010). Yields for most crops (including groundnut, Irish potato, sorghum, rice, cotton, maize, beans, sweet potato and millet) declined between 1999 and 2006 (ibid).

Further, the share of manufacturing in GDP has declined during the last decade (see figure 3). It currently stands at around 7 per cent (down from 8.4 per cent in 1997), which is far behind the average of 24 per cent for other developing countries as well as below the average of 11 per cent for Least Developed Countries (UNCTAD 2008, p. 7).

Figure 3. Manufacturing as share of GDP, 1980-2008.



Source: World Bank, World Development Indicators

Manufacturing in Uganda is dominated by agro-processing activities (including cotton ginning, tea processing, coffee hauling, tobacco handling and processing, beverages, wheat products and dairy products). The manufacturing sector is characterised by low capacity use, standing at an estimated 50 per cent of installed capacity (Republic of Uganda 2010, April, par. 309). A host of constraints inhibit manufacturing output growth including supply constraints, power shortages, credit rationing, a skills deficit, inadequate physical infrastructure, low science, technology and innovation capabilities, and unreliable supply of inputs. In particular, the agricultural sector “has not effectively

implemented a production programme that would help ensure a reliable supply of industrial raw materials” (Republic of Uganda 2010, April, 121).¹⁶

As a result of its poor performance, the manufacturing sector is not operating as an immediate alternative employer to agriculture. The National Development Plan further highlights the following pernicious features of the sector (p. 205):

- Merchandise exports are dominated by primary commodities. On average, between 2003-2007 five commodities (coffee, cotton, tobacco, tea, fish and fish products) made up over half of Uganda’s exports (Uganda Bureau of Statistics 2009);
- The industrial sector is largely informal characterized by production of low quality goods and gross deficiencies in technology;
- Lack of indigenous capacity;
- Little attention to research;
- Low development and innovation;
- Lack of foundational engineering industries and foundries necessary for the manufacture of tools and spare parts for use in different industries and the generally poor state of roads and rail infrastructure that makes supplies and distribution of goods costly.

The structural transformation “in terms of a genuine change from predominantly subsistence agriculture to an economy with a commercial agricultural sector and increasing manufacture” has hence not materialised in Uganda (Joughin and Kjoer 2010).¹⁷ In this context, the recent World Bank Country Assistance Strategy (World Bank 2010, paragraph 36) observed the following:

The country’s uninterrupted growth since 1987 has been a noteworthy achievement. However, the weak point of economic performance has been the limited shift from a low-productivity, primary-based economy to a high-productivity economy based on industry and services. The country’s high population growth rate makes structural transformation particularly urgent to create non-agricultural and higher-productivity jobs for one of the fastest growing labour forces in the world.

On the one hand, these features indicate the failure to develop new productive capacities in the country and highlight the poor state of the existing productive base of the economy. On the other, they point towards a persistently lop-sided integration into the global circuits of production and trade. We consider each in turn.

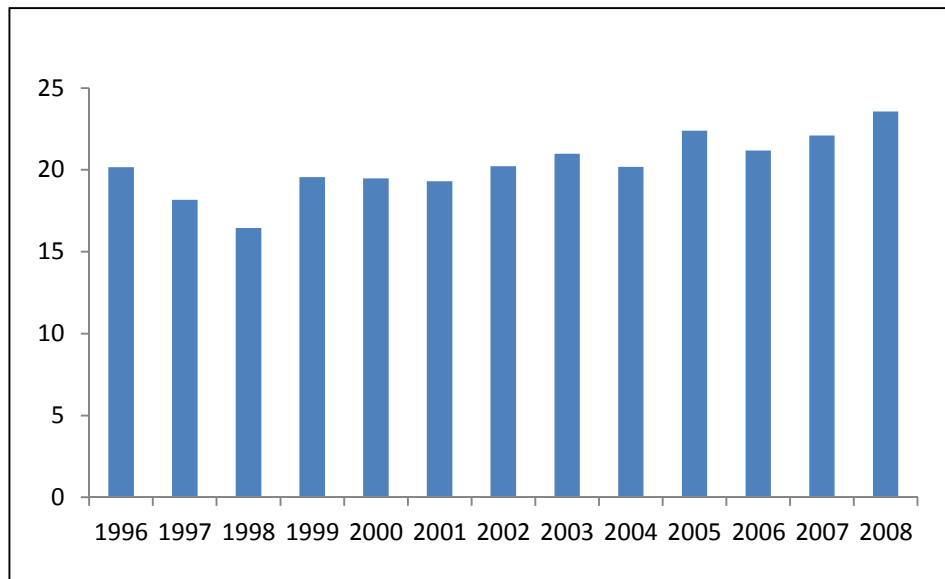
First, underlying the trends of insufficient generation of productive employment are inadequate investment levels (in terms of increasing productive capacity). Investment levels have only increased moderately during the 2000s, and gross capital formation as a share of GDP has remained around 20 per cent since the early 2000s, standing at 23.5 per cent in 2008 (see Figure 4). This compares to investment-to-GDP ratios of more than 30

¹⁶ See also the National Industrial Policy (Republic of Uganda 2008, p. 13) where it is aptly observed that the growth prospects of the manufacturing sector are closely linked with the performance of the underlying raw material suppliers, especially food and fibre: “Uganda’s low on-farm agricultural productivity limits the cost competitiveness of agricultural raw material available for industrial processing and full exploitation of the agricultural potential of Uganda. High post-harvest losses are also recorded in most of the agricultural products. Quality management of this material is also a constraint”.

¹⁷ Joughin and Kjaer (2010, p. 3) quote a former official who stated that “[P]roduction, real production has not grown. There might be 6 per cent GDP growth but if you look at what it is, it is mostly such activities as construction of roads...or CHOGM (Commonwealth Heads of Government Meetings) hotels, or trading mobile phones – not real production”.

per cent in the East Asian economies during their high growth periods of the 1970s and 1980s (see Muqtada 2010).

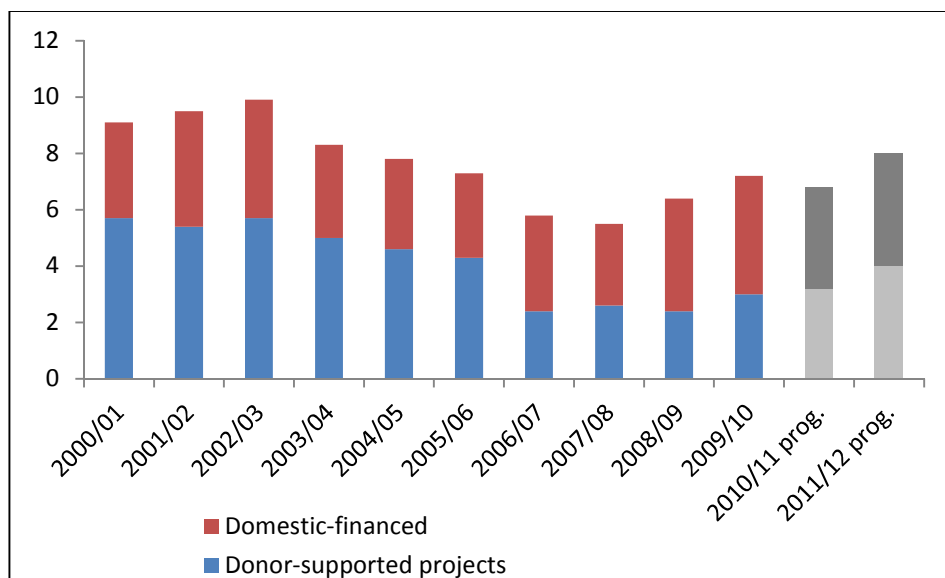
Figure 4. Total (private and public) gross capital formation as a share of GDP (1996-2008)



Source: World Bank, World Development Indicators.

Further, while private investment rose from 12.2 per cent in 2000/1 to 20.6 per cent in 2006/7, this has mainly consisted of increases in private construction (residential buildings). There have only been very modest increases in machinery and equipment investment and public construction has remained low (Republic of Uganda 2010, April, p. 10). Significantly, public investment has stagnated to below 6 per cent of GDP per year over the same period (see figure 5), an issue we return to in Section 6 below.

Figure 5. Public Investment as a share of GDP (2000/01-2011/12)



Source: IMF, Article IV documents, various years.

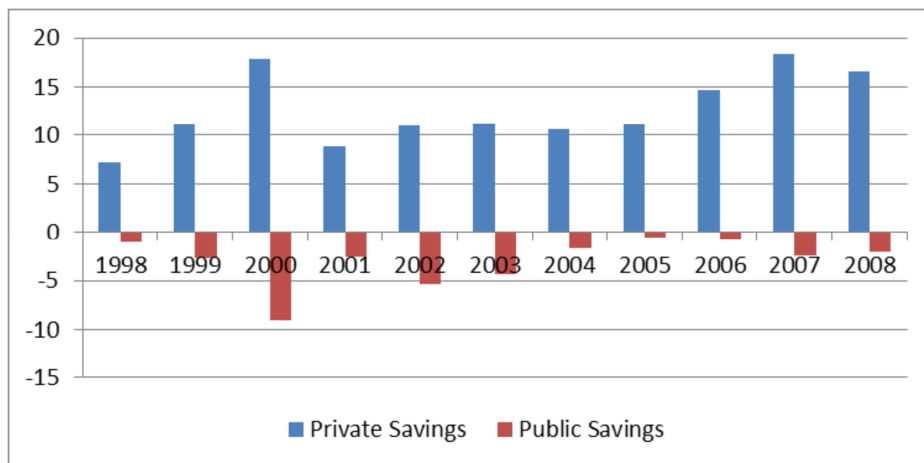
Foreign direct investment has increased in absolute terms over time, although it has declined somewhat following the crisis. FDI to GDP ratios stand at around 5 per cent (5-year average for the period 2005/06-2009/10). FDI has been directed mainly towards natural resources, including oil and electricity generation. The telecommunications sector

has also witnessed important FDI presence (see Ssewanyana and Bategeka 2010). In the context of FDI and manufacturing, Rasiah (2009) shows that potential benefits from FDI for the domestic manufacturing sector, for instance, in terms of learning and technological intensity have not lived up to expectations (quoted in UNCTAD 2009, p. 171).

A worrying trend accompanying the poor investment performance in Uganda is the insufficient growth in total savings as a share of GDP. This stood at 14.5 per cent in 2008 (see figure 6) and compares to an average of 20.7 per cent for least developed countries (gross domestic savings as a share of GDP in 2006) (UNCTAD 2009, p. 10). While private savings have increased recently in Uganda, they remain grossly inadequate in terms of domestic resources available for financing investment.

Matovu (2010) outlines various reasons for the low private savings rates in Uganda. He argues that savings in Uganda are often held in non-financial assets making them less readily available for long-term and large-scale investments. Most formal financial institutions are located in urban areas, complicating access for those living in rural areas. Within the formal banking sector, weak competition, high overhead costs and poor credit information translate into wide spreads: borrowers can pay as much as 24 per cent, while savers earn only 4 per cent.

Figure 6. Public and private savings in Uganda as a percentage of GDP (1999/2000-2008/09)



Source: Matovu (2010)

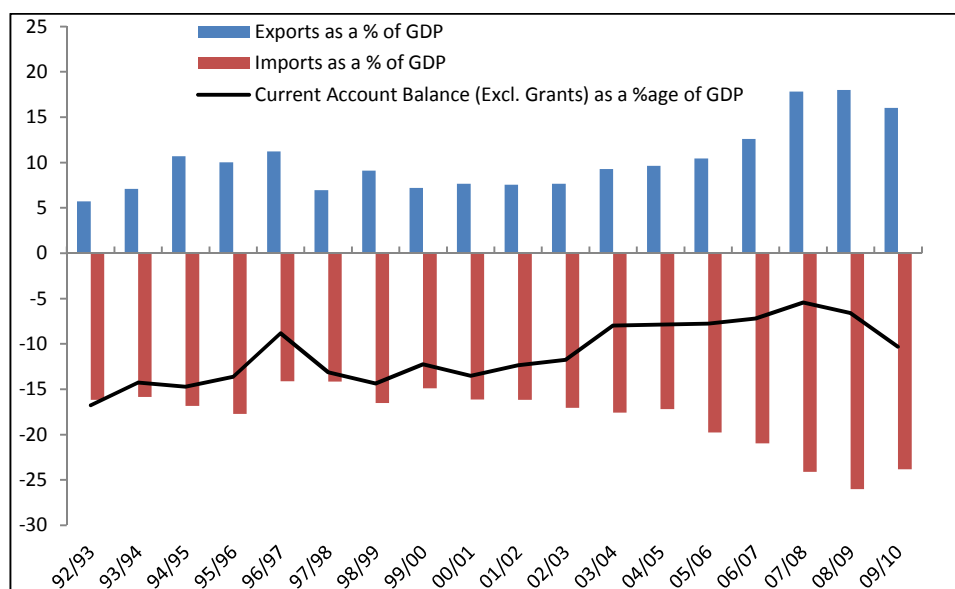
Second, the nature of the integration of the economy in the world economy has important implications for the quantity and quality of employment created. Weeks (2004, p. 3) observes how: “(b)oth the rate of economic growth and its distribution across sectors and households are influenced by the integration of each country into the world market. Since economic growth and its distribution affect the growth and structure of employment, the quantity and quality of employment affect poverty, it follows that external factors influence poverty reduction to varying degrees in every country”.

Uganda has had disappointing growth rates in the volumes of its major export commodities over the 1990s and early 2000s. In the context of a heavy reliance on imports, this has implied a persistent gap between imports and exports (see figure 7).¹⁸ This tends to reflect severe and multiple supply-side constraints on its major export commodities, rather than deteriorating demand conditions in the region or world

¹⁸ In interview, one of our respondents referred to Uganda as having become a “fortress for imports”.

economy.¹⁹ Ugandan exports also remain dominated by low (or non-) value added (agricultural) commodities.²⁰ Manufactured or processed products accounted for less than a quarter of Uganda's exports over the period 2003-2007.²¹ The remaining 75 per cent of merchandise exports were composed of unprocessed agricultural and mineral commodities. On the services side, tourism has been a stable earner for Uganda. Travel receipts have steadily increased from around one per cent of GDP in the early 1990s to 3.8 per cent of GDP in 2009/10 (UBOS, Balance of Payments Statistics).

Figure 7. Uganda's current account balance (1992/93-2009/10)



Source: UBOS, Balance of Payments Statistics

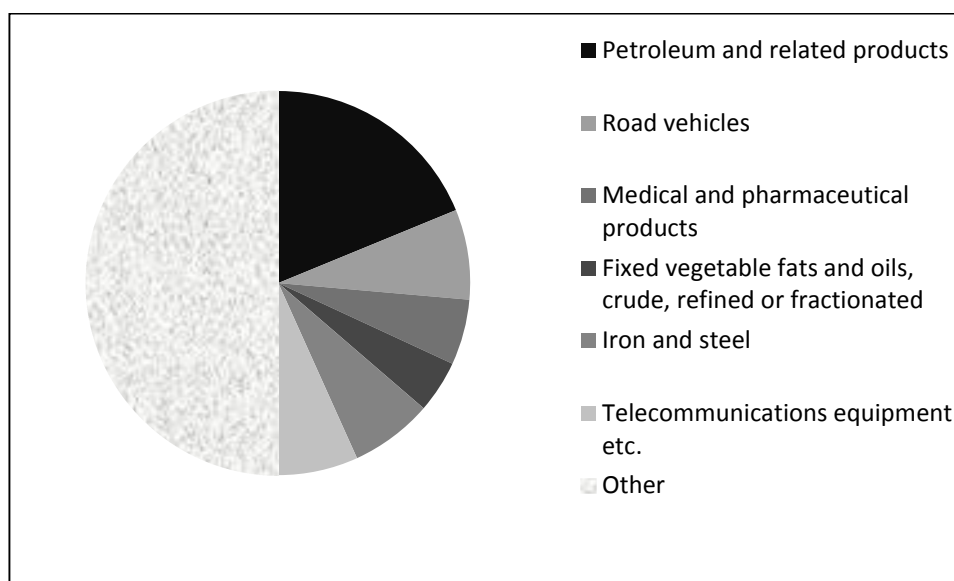
In terms of imports, Uganda heavily depends on a number of countries (mainly in Asia) for a diverse set of products (see figure 8). Oil and heavy machinery goods dominate the picture. The origin of the vast majority of Uganda's imports in 2008 were, in order of value, the EU, Kenya, United Arab Emirates, India and China (Uganda Bureau of Statistics 2009).

¹⁹ Volumes of coffee exports, for instance, have been stagnant for the last decade despite price increases during the 2005-7 period (see Sender and von Uexkull 2009).

²⁰ The National Development Plan (Government of Uganda 2010, April, p. 11) recognises that whereas imports are becoming more technically advanced, exports are still dominated by primary commodities. "This contrasts with some East Asian economies where exports were dominated by manufactured products. This means, therefore, that the future growth of the service and manufacturing sectors will have to undergo transformation to include new technologies in order to be more competitive in the export market".

²¹ Note that manufactured and processed products exclude fish and processed fish-related products.

Figure 8. The composition of Uganda's imports in 2008



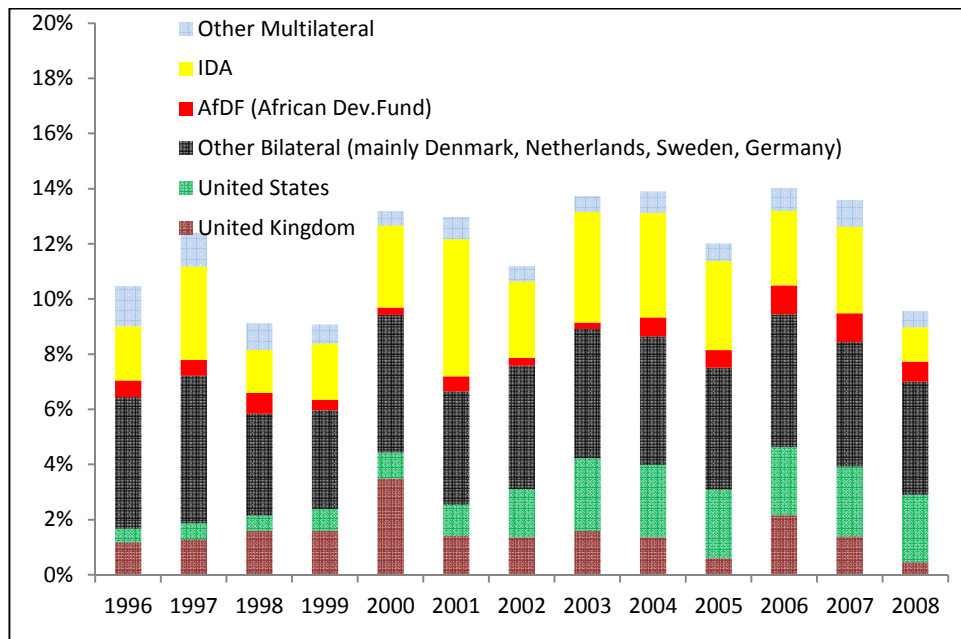
Source: UBOS, Balance of Payments Statistics

To finance the persistent trade deficit, the Ugandan economy has been heavily reliant on aid. During the period between 2000 and 2008, the aid/import ratio averaged 45 per cent, while the aid/GDP ratio averaged 14 per cent (World Bank, World Development Indicators). Aid dependence has its own hazards of volatility, high transaction costs and cumbersome conditionality.

Overseas Development Assistance (ODA) has fluctuated over the last decade, averaging around 14 per cent of GDP. Generally, Uganda's dependence on ODA as a share of GDP has declined over time, having reached a peak of 25 per cent in 1992.²² Figure 9 illustrates the fragmentation, and to some extent the volatility, of aid over the period between 1996 and 2008. The USA is currently Uganda's largest bilateral donor, while grants from IDA (World Bank) and the UK have shrunk in relative terms over the last decade. In total, Uganda received ODA from 20 bilateral and 16 multilateral donors in 2008, with significant implications for the resources necessary to manage these various relationships. Further, often delays or failures to disburse committed aid flows occur, with negative impacts on planning and the implementation of development programmes (Republic of Uganda 2010, April, p. 37). With around 30 per cent of the government's budget funded through aid, any delay in disbursements will have immediate effects on planned expenditures.

²² The increase in the aid to GDP ratio in 2006 includes debt relief provided through the Multilateral Debt Relief Initiative (Overseas Development Institute 2010).

Figure 9. Overseas Development Assistance as a percentage of GDP and by Main Donors



Source: OECD/DAC Database

4. Challenges facing the Ugandan economy

The Ugandan economy has been characterised by a lack of structural transformation towards high-productivity sectors capable of absorbing a fast-growing population. Growth in the agricultural sector has been slow and particularly insufficient in the last ten years. Primary commodities continue to dominate industrial products as exports. Exports remain characterised by low-value added commodities and are insufficient to pay for the import bill. Aid fills a large part of the trade gap, being subject to its own hazards including unpredictability and high transaction costs. Investment in productive capacity remains low and the national savings rate has stagnated, if not declined, over the last few years.

It has recently been reiterated by UNRISD (2010, p. 29) that:

A fundamental precondition for poverty reduction is a pattern of growth and structural change that generates productive employment, improves earnings and contributes to the welfare of the population. Employment policies must figure centrally in development strategies if such a pattern of growth is to occur.

The Report continues that “(p)ublic policy is critical for generating a pattern of structural change that creates employment and reduces poverty”. In most general terms, public policy will need to address the insufficiency of labour demand together with the poor quality of existing employment.

It is crucial, then, that Uganda’s future development trajectory allows for employment-intensive growth, if an expansion of productive employment and decent work for all is to be attained (and that specific measures are taken – and implemented – regarding social protection). This will necessitate a macro policy stance that puts public investment at its centre and which is accompanied by targeted or focused sectoral policies that seek to ensure that increased investments translate into changes in the patterns of employment.

We argue below that, on the one hand, this requires a different macroeconomic policy framework than what has traditionally been adhered to in Uganda, where a liberal stance across fiscal, monetary, exchange rate and capital account policies has hindered a more employment-sensitive development or growth trajectory; and that, on the other, the policy focus needs to go beyond the macroeconomic such that sectoral policies, in particular for agriculture and manufacturing, produce defining imperatives at the macro-level.

With regard to the former, Saad-Filho (2007, p. 517) correctly observes that:

(m)acroeconomic stability is evidently an important constraint to the achievement of pro-poor outcomes, including rapid growth, redistribution and the structural transformation of the economy. Stability includes, at a minimum, inter-temporal fiscal and balance of payments equilibrium, real exchange rate stability and the minimisation of inflation and macroeconomic volatility.

However, he continues that these “are not objectives in themselves but such stabilising policies serve to correct problems that interfere with the achievement of pro-poor goals”. He proposes for stability to be pursued for its instrumental value, in support of a pro-poor programme, rather than that it be elevated to an objective in itself: “the preservation of stability should not become an objective in itself, much less an excuse to undermine the government’s pro-poor programme”. It has probably been overstated, but as was recently reiterated in UNRISD (2010, p. 1):

(c)ountries that seek to expand employment opportunities must adopt macroeconomic frameworks that avoid restrictive monetary and fiscal policies during periods of poor growth since they tend to reduce the growth of domestic demand, which affects employment generation.

Further, the connections between macro-policy and structural policy, in which the links between sectoral policies, trade and macroeconomic growth contribute significantly to economic dynamism, need to be teased out explicitly and need to drive the design of policies at the macro level for successful structural diversification to occur (rather than that sectoral policies remain subservient to a set of market-based macro policies) (Bradford 2005, p. 14).

Finally, a strategy that puts public investment at its centre needs to ensure that the latter is explicitly linked to efforts to expand employment opportunities. In this context, the National Employment Policy emphasises the importance of linking the various expenditures that are pledged in the latest National Development Plan, see Section 5 below, to the rapid expansion of employment opportunities in rural areas. It is suggested that this could be done by “making employment creation a key criterion in selecting between alternative public and private investments, programmes and projects; ensuring that rural infrastructure investments are constructed using labour-based techniques” (Ministry of Gender, Labour and Social Development 2010, p. 18).

5. The National Development Plan

In the context of these various challenges facing the Ugandan economy, the National Development Plan (Republic of Uganda 2010) seeks to put economic transformation and wealth creation at the heart of its strategy. The proclaimed theme of the Plan is “growth, employment and socio-economic transformation for prosperity”. At the most general level, the Plan seeks to raise average per capita income levels, improve the labour force distribution in line with the sectoral GDP shares, raise the country’s human development indicators, and improve the country’s competitiveness to levels comparable to middle income countries (Republic of Uganda 2010, April, p. 4).

To achieve the Plan’s general aims, eight strategic objectives are singled out: increase household incomes and promote equity; enhance the availability and quality of gainful employment; improve the stock and quality of economic infrastructure; increase access to quality social services; promote science, technology, innovation and ICT to enhance competitiveness; enhance human capital development; strengthen good governance, defence and security; promote sustainable population and use of the environment and natural resources.

The National Development Plan identifies a set of “binding constraints” operating on its strategic aims. The constraints are identified as follows: weak public sector management and administration; inadequate financing and financial services; inadequate quantity and quality of human resources; inadequate physical infrastructure; gender issues, negative attitudes, mind-set, cultural practices and perceptions; low application of science, technology and innovation; and inadequate supply and limited access to critical production inputs (such as fertiliser, irrigation, cement, steel, etc.).

The Plan recognises that to address these constraints particular attention should be given to harnessing inter-sectoral linkages, functional relationships and synergies among economic sectors, which, it admits, have received insufficient attention in the past (p. 6). To operationalize this approach, the economy is conceptualised as consisting of four sector-clusters. First, there are the primary growth sectors directly producing goods and services (agriculture, forestry, tourism, mining, oil and gas, manufacturing, information and communication technology, and housing/construction). Second, the complementary sectors comprise sectors and sub-sectors that provide institutional and infrastructural support to primary growth and other sectors (science and technology, transport, energy, water for production, land management and administration, physical planning, urban development, trade development, financial services, cooperatives). The third cluster consists of the social sectors (population, labour and employment, education and sports, skills development, health and nutrition sector, HIV/Aids, water and sanitation, social development). And, finally, the “enabling” sectors encompass sectors and sub-sectors “that provide a conducive environment and framework for efficient performance of all sectors of the economy” (legislature; justice, law and order, national defence and security, environment, climate change, water resource management, meteorology sector, wetland management, national statistics, standards and quality infrastructure, public sector management, accountability sector, disaster management, sub-national development, EAC integration, public administration, regional and international cooperation) (p. 6).

Further, the Plan projects for a “quasi-market approach” to be pursued, which “includes a mix of government investments in strategic areas and private sector market driven actions” (p. 43). The role for the government in the Plan is understood in terms of an enabling state partnering with the private sector (p. 43):

The private sector will remain the engine of growth and development, while Government in addition to undertaking the facilitating role through the provision of a conducive policy, regulatory and institutional framework, will also actively promote and encourage public-private partnerships in a rational manner.

Across the seven constraints identified as binding, a set of strategic actions is then proposed (see pp. 44- 48 of the National Development Plan, April, for a list of these). In addition, specific national “core” or “flagship” projects are identified which are perceived as critical “for catalysing the transformation of the economy”. Within these, infrastructure for the oil and gas sector is prioritised.²³ This is followed by power projects to increase electrification in the country. Investments in roads and rail are also identified as core projects, continuing a focus on transport that was initiated in 2007 (see Booth and Golooba-Mutebi 2009). As part of industrial development, the construction and development of a phosphate plant is proposed (Tororo) to provide fertiliser to farmers “at affordable price”. This is complemented by a core project seeking to support the development of the iron ore industry to provide ingots for the steel industry. Finally, a set of interventions seeks to improve access to water for production, including for irrigation, livestock watering and rural industries.²⁴

It is asserted by the Plan that these core projects will take the first call on budget resources. However, most of the core projects will be executed through Public Private Partnerships (PPPs), with varying levels of government involvement (p. 54). This reflects a persistent commitment within the Plan to a “stability”-driven macroeconomic environment, an issue we further elaborate upon in Section 6 below.

Before we proceed, however, we offer a brief preliminary assessment of the Plan on the basis of the material we gathered during interviews.

The National Development Plan emerged in an attempt to move away from the Poverty Eradication Action Plan (PEAP) process, in which the agenda of poverty reduction (apart from macroeconomic stability) had driven the policy process without much explicit concern for employment. A perception prevailed within government circles that policy had been excessively driven by concerns for social sectors (apart from macroeconomic stability) rather than the productive sectors. The National Development Plan officially sought to rebalance policy as to incorporate longer-term issues related to productive capacity and employment.

From interview we gathered that there was initially some hostility to the process, as individuals within e.g. the Ministry of Finance, Planning and Development (MOFPED) and the Bank of Uganda (BOU) perceived the National Development Plan to involve a return to some form of central planning and a perception prevailed, within certain circles of government, that the creation of a National Planning Authority could compromise macroeconomic stability. The creation of the National Planning Authority also implied some uncertainty regarding respective mandates, given that MOFPED is officially also responsible for planning. (For certain interviewees, the existence of the Plan was then in itself already some form of success or victory over the more conservative circles in government. Although for others, MOFPED remained “the womb” out of which the

²³ This includes: developing an oil refinery which is to commence production of processed oil products in the Albertine Graben area; the construction of a pipeline for transporting oil products; completion of the pipeline from Eldoret to Kampala; and facilitating further exploration of oil fields.

²⁴ For the full list of the national core projects, see Table 4.9 of the National Development Plan, April version.

National Planning Authority had emerged and the need to separate planning from the Ministry of Finance was emphasised.)

Further, the Plan seems to have come about as a collaborative exercise between a set of line ministries. This collaboration was repeatedly pointed at as an important aspect of the Plan, in that it implied that ministries needed to be aware of the implications of their demands for other ministries, as well as brought to the fore various intersectoral linkages. As such, the drafting of the National Development Plan functioned as a platform for intersectoral dialogue, which was repeatedly pointed at as an important achievement in itself.

Yet, in terms of participation of social partners in the discussion and drafting of the NDP, we consistently gathered from different interviews that the trade unions had been barely involved in the process. Trade union officials we spoke to thought it unfortunate that trade unions are not considered important partners in the policy-making process. This is compounded by lack of capacity within the trade unions to engage in debates on macroeconomic policy. Further the National Development Plan was adopted as the country's planning framework without approval and adoption by Parliament, which was in contravention to the legal framework surrounding the creation of the National Planning Authority (section 8(6) of the NPA Act). This was remedied through a retrospective approval process (Parliament of Uganda 2010).²⁵

As any other such document would, the National Development Plan went through a set of drafts.²⁶ For the initial draft of the section on the macroeconomic strategy (section in chapter four of the Plan), the National Planning Authority collaborated with a World Bank economist, who sought to provide a projection of fiscal policy on the basis of a General Equilibrium simulation to achieve a set of MDG targets (“Maquette for MDG Simulation - MAMS”). This generated an initial projection of a budget deficit around 13 per cent of GDP. This figure provoked strong criticism from the Governor of the Bank of Uganda, and MOFPED was subsequently tasked to lead on the macroeconomic section of the Plan. This led to a fiscal policy scenario at the heart of the Plan that is very much in line with the previous fiscal stance of the Government of Uganda – projecting a fiscal deficit not to exceed 6 per cent, and which, it is argued, is also driven by the convergence criteria of the East African Community (see below). This constrains government spending as a whole and steers the expenditure patterns of the future. As a result any project proposed in the Plan that cannot be financed by the government as a result of this fiscal stance, will need to attract private financing through public-private partnerships (PPP). In this context, the parliamentary committee on the National Development Plan noted that a policy and the enabling law on PPPs is not yet in place in the country and recommended that these be enacted as soon as possible (Parliament of Uganda 2010, p. 15).

As a result, what may seem at first glance as an ambitious refocusing of the national development strategy, appears more tenuous on closer inspection, once it becomes clear that a host of important projects are dependent on whether the private sector will be forthcoming with funds.²⁷ This may be the reason why, during interviews, doubts were

²⁵ This did not happen, however, without an explicit reprimand by the Committee (Parliament of Uganda 2010, p. 14): “The committee now wishes to caution the line Minister to learn how to respect institutional arrangements so as to avoid retrospective approval in future”.

²⁶ One rather awkward feature of the different drafts are the sometimes very different data including on such crucial issues as, for example, projected budgetary allocations.

²⁷ It should be noted, although not with much surprise, that the Bretton Woods Institutions are very keen on the centrality of PPPs to the National Development Plan. The Joint Staff Advisory Note – the National Development Plan functioning as Uganda's latest Poverty

repeatedly expressed regarding whether the Plan was backed by sufficient resources to operationalize it, and hence to what extent various parts of the Plan would ultimately be implemented. In light of this concern, the Parliamentary Committee recommended: “that [the] NPA ranks the binding constraints to reflect the order of priority and critical need so as to prioritize budget funds allocation” (Parliament of Uganda 2010, p. 15).²⁸

A closer look at the National Budget Framework Paper (Ministry of Finance, Planning and Development 2010) for the period covering the Plan, 2010/2011 – 2014/15 (see table 1), further reveals a divergence between the fiscal projections in the National Development Plan – themselves already subservient to a rather orthodox fiscal agenda officially attributed to the need to satisfy EAC convergence criteria – and the government’s budget.²⁹

Table 1. Selected economic indicators under projections of the current budget framework, the NDP and the EAC convergence criteria

Indicator	Current Framework						NDP						EAC (convergence criteria)					
	09/10	10/11	11/12	12/13	13/14	14/15	09/10	10/11	11/12	12/13	13/14	14/15	09/10	10/11	11/12	12/13	13/14	14/15
GDP Growth	5.6%	6.4%	7.0%	7.2%	7.4%	7.5%	6.4%	6.6%	7.0%	7.3%	7.4%	7.5%	>7.0%	>7.0%	>7.0%	>7.0%	>7.0%	>7.0%
Inflation	7.0%	4.5%	4.9%	5.1%	4.9%	4.9%	7.9%	7.5%	6.0%	6.9%	6.8%	6.8%	<5.0%	<5.0%	<5.0%	<5.0%	<5.0%	<5.0%
Reserves/Months	5.0	4.8	5.1	5.7	5.7	5.7	5.1	5.1	5.3	5.5	5.6	5.7	4.0	>6.0	>6.0	>6.0	>6.0	>6.0
Fiscal Deficit Excluding Grants	-4.9%	-5.6%	-5.2%	-4.2%	-3.7%	-3.4%	-5.0%	-6.1%	-6.2%	-5.7%	-5.2%	-4.3%	<6.0%	<5.0%	<5.0%	<5.0%	<5.0%	<5.0%
Budget as %age of GDP	17.7%	18.4%	18.7%	18.2%	18.2%	17.9%	17.8%	19.2%	19.8%	19.8%	19.8%	19.4%						
External Aid % of GDP		5.0%	4.7%	3.8%	3.5%	3.1%	5.2%	5.4%	5.6%	5.1%	4.6%	3.7%						
Domestic Revenue %age of GDP	12.7%	13.0%	13.5%	14.0%	14.5%	14.5%	12.8%	13.1%	13.6%	14.1%	14.6%	15.1%						20%

Source: MOFPED (2010, p. 20)

Reduction Strategy Paper –notes (IDA/IMF 2010, paragraph 7): “the implementation of the ambitious public investment program should be mindful of preserving space for private sector initiative and development. In this respect, the legal and fiscal frameworks for PPPs could be reviewed and strengthened as needed”. This combines with a reluctant endorsement by the BWIs of the Plan’s strategy to increase public investment in infrastructure: “The expanded provision of public services, particularly in infrastructure should pave the way for increased private sector investment. Nevertheless, staff encourages the authorities to be mindful of the risks of crowding out the private sector, and more broadly to ensure that adequate space is left for private initiative in key and other sectors” (IDA/IMF 2010, paragraph 19).

²⁸ The Committee expressed the view that both physical and technological infrastructure should be the first top priority binding constraint (Parliament of Uganda 2010, p. 15).

²⁹ This is reminiscent of an earlier assessment of the PEAP process. Canagarajah and van Diesen (2011, pp. 138-9) observed: “To many stakeholders outside the MFPEP, the third PEAP thus reads as if its ambitious priorities are largely constrained by existing overall and sector-specific expenditure- allocation ceilings set out in the Medium Term and Long-Term Expenditure Framework. The highly consultative process of preparing the PEAP generated many ideas and much progressive thinking about poverty reduction, some of which may have been inconsistent with traditional budget priorities as envisaged by MFPEP officials. However, the ultimate dominance of MFPEP in priorities setting for the PEAP may have meant that these new ideas were not drawn upon to the extent that was possible”.

The Framework Paper explains these downward adjustments on the projections in the budget framework as compared to the National Development Plan as follows (p. 20):

Macroeconomic balance is a key condition for economic growth and poverty reduction ... the current projections for financial resources (external aid and domestic revenue) are less optimistic compared to those set out in the National Development Plan ... For example, to achieve the EAC fiscal deficit (excluding grants) of no more than 5 per cent of GDP by 2014 implies that the government will either hold back its level of expenditure or it will have to increase significantly domestic revenue collections ... Alternatively, the country would be faced with a trade-off between aiming to achieve the EAC convergence criteria as opposed to making the necessary investments in infrastructure to bridge the huge infrastructure gaps that the country faces.

The issue of the discrepancy between the resource projections in the National Development Plan versus those of the budgetary framework was also highlighted by the Parliamentary Committee on the National Development Plan: “This difference in projections by MFPED and National Development Plan is very significant and if these projections are not harmonised, the implementation of the National Development Plan in the medium term is likely to fall short of its expectations”. The committee recommended that the NPA in consultation with MFPED “harmonise projections of the resource envelope for the effective implementation of the National Development Plan” (Parliament of Uganda 2010, p. 17). The issue of inconsistency, finally, did not only arise in the context of the projected total resources available to implement the National Development Plan, but also regarding the prioritisation of budgetary allocations between sectors (Parliament of Uganda 2010, p. 17).

6. Trajectories of macroeconomic policies: constraints or opportunities?

Having set out the context in which Uganda aims to implement its new National Development Plan in Sections 2 and 3 above, we now turn to an appraisal of the extent to which macroeconomic policies in Uganda support the broad ambitions of the National Development Plan, which include “growth, employment and socio-economic transformation for prosperity”- as laid out in Section 5 above.

In particular, this section assesses the alignment between macroeconomic management and the broader economic goals of growth, structural change, employment and poverty reduction in Uganda. This is done in *four specific policy areas* - fiscal policy, monetary policy, exchange rate policy and capital account management. In order to frame our assessment, each section includes a brief indication of general principles of a macroeconomic framework that puts the goals of employment-creation and structural change at its centre, as well as concludes with proposals for alternatives.

Yet, and this anticipates our argument in the concluding section of this Report below, promoting alternative employment-sensitive macroeconomic policies, as laid out for each policy area in this Section, is not sufficient to generate the structural changes that are required in the Ugandan economy for the realities of “full and productive employment and decent wages for all” to materialise. The recommendations we make for each specific policy area should therefore not be interpreted on their own, but assessed in conjunction with focussed sectoral policies as well as labour market policies, briefly discussed in the concluding section of this Report.

In general, our appraisal is that macroeconomic policy in Uganda since the early 1990s has been driven by a main concern, initially, for a return to, and then continuing price stability, which has translated into tight monetary and fiscal policies. This has been combined with a commitment to a flexible exchange rate (since 1993) and an open capital account (since 1997) – apart from extensive privatisation and deregulation efforts. The combination of these features has tended to imply a relatively low level of direct control by the state over the direction of accumulation in the economy, underpinned by the idea that, instead, the dynamics from within the private sector will deliver in this regard. Yet, as was indicated above in Section 3 such a course has not generated the necessary structural diversification and upgrading of the economy.³⁰

Further, although this Report was written against the backdrop (and probably because of) the advent of the global financial and economic crisis, the policy response by the Ugandan authorities to the implications of the crisis has not been pronounced, with the preceding monetary and fiscal stances remaining largely unchanged (see also Ssewanyana and Bategeka 2010). The implications of the global financial and economic crisis for Uganda mainly took effect through the external account (in terms of reduced capital flows and remittances) and will be discussed here in the context of the policies pertaining to the exchange rate and the capital account.

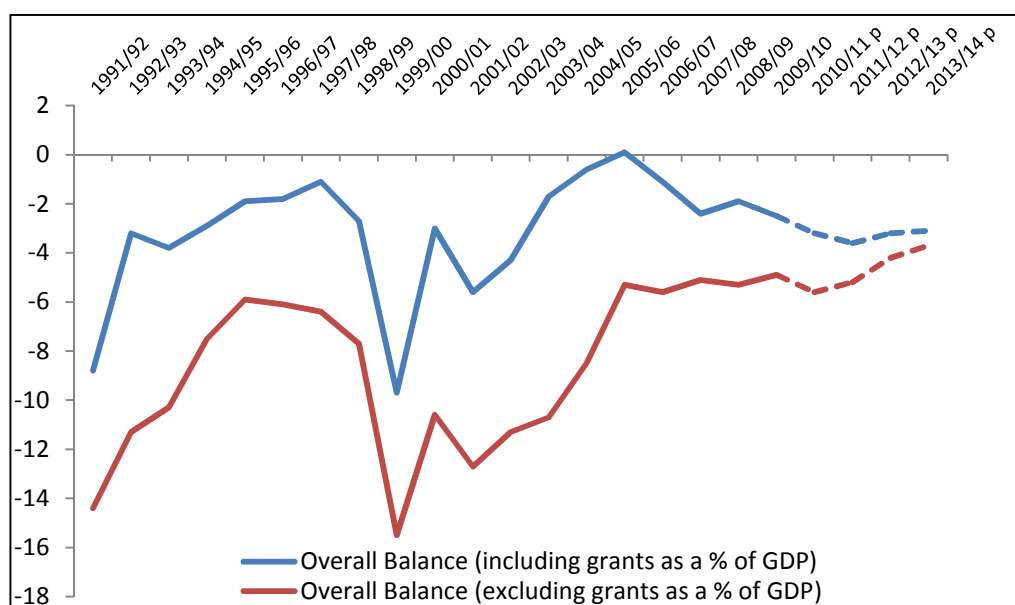
³⁰ See Weeks and McKinley (2007) for a general critique of such macroeconomic policies. See also Brixiová and Ndukimana (2010) for a recent appraisal of the performance of such macroeconomic policies across Sub-Saharan African countries.

6.1 Fiscal policy

In Section 4 above, the need for a focus on public investment linked to employment-generation and structural change was highlighted. This focus on public investment requires fiscal policy to be adaptable and long-term in its objectives, help to boost aggregate demand, relieve supply and infrastructure constraints and crowd in private investment (Saad-Filho 2007). In general, implementing a large-scale public investment programme will require flexibility in the fiscal framework. Flexibility is also needed to allow a low-income country, like Uganda, to adjust to unforeseen circumstances and external shocks.

In Uganda, however, fiscal policy seems to have been predominantly driven over the last decade by a trend of fiscal consolidation, where the fiscal balance (excluding grants) has been gradually brought down from double-digit deficits in the early 2000s towards deficits of below 6 per cent of GDP since 2005/06, reaching -4.4 per cent in 2008/9, -5 per cent in 2009/10 and projected to decline further to just over -3 per cent by 2014/15 (see figure 10).

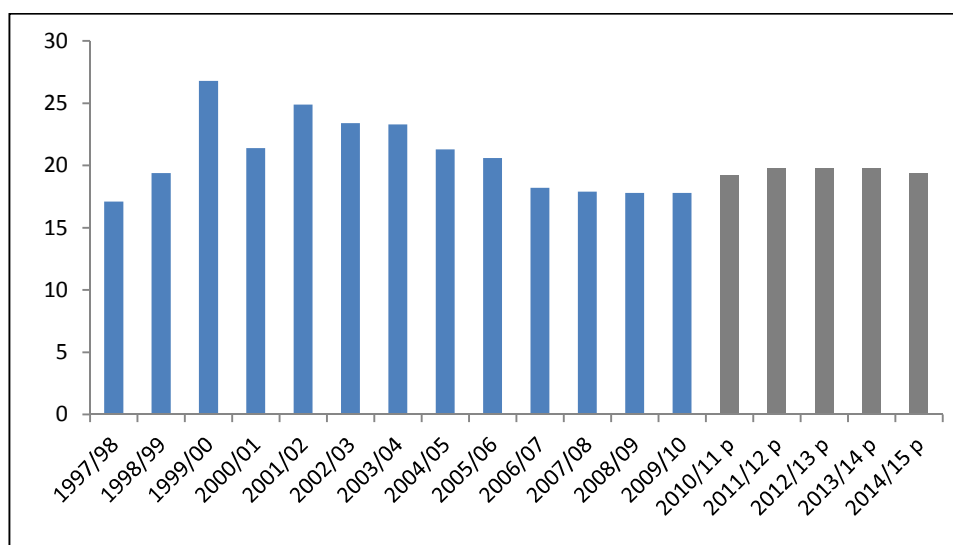
Figure 10. Uganda's Overall Fiscal Balance (% of GDP)



Source: IMF, Article IV Consultations, various years.

The reduction in the fiscal deficit over the 1990s and 2000s in Uganda has largely been achieved by reductions in expenditure rather than significant improvements in revenue mobilization. Figure 11 indicates how, since fiscal year 2001/02, government expenditure as a share of GDP has initially declined and then stagnated. It is further projected to remain at a level below 20 per cent in the next few years.

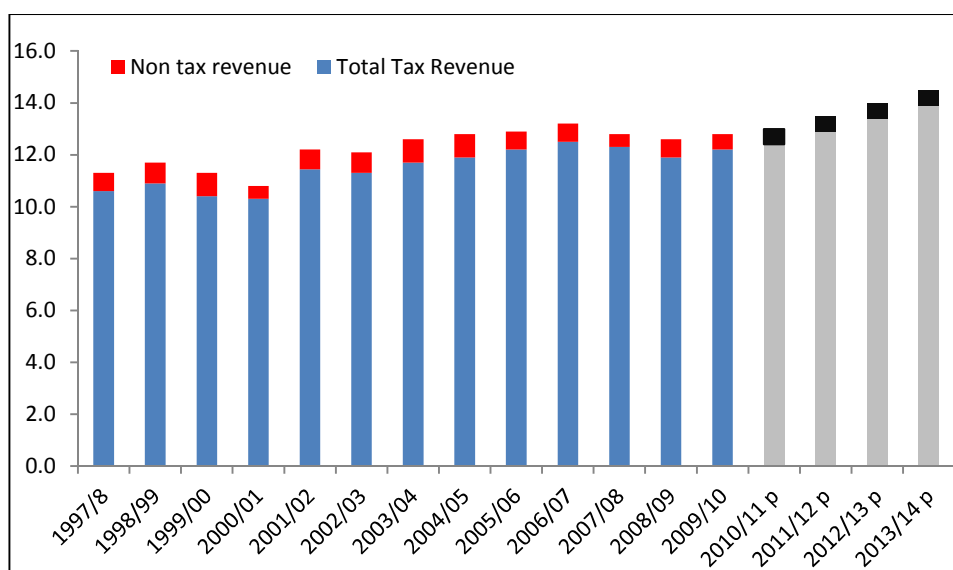
Figure 11. Government Expenditure as a % of GDP (1997/98-2009/10)



Source: IMF, Article IV Consultations, various years

Figure 12 indicates how the revenue performance of the Ugandan government has barely improved over the last ten years, hovering around a low 12 per cent of GDP. This is the lowest amongst the East African Community countries.

Figure 12. Revenue Performance as a % of GDP (1997/98-2013/14)



Source: IMF, Article IV Consultations, various years; MFPED projections taken from National Budget Framework Paper, 2010

Projected increases in revenue are intended to come from increases in income tax through PAYE, as well as from domestic consumption tax increases (VAT). International trade taxes are also set to increase but by around half as much. Even with the inclusion of these ambitious targets for income and consumption tax collection, Uganda’s revenue performance will still remain below that of its neighbours and other low-income countries.

The discovery of oil and the increased revenues that this will generate may give Ugandan authorities further fiscal space in the future.³¹ However, revenues from oil will not come on stream until 2016 at the earliest. Furthermore, in order to exploit these resources, large investments will be required for further exploration, development and extraction, and related infrastructure. It was already indicated in Section 5 above how an important part of the National Development Plan focuses on enabling prospective oil exploitation.³²

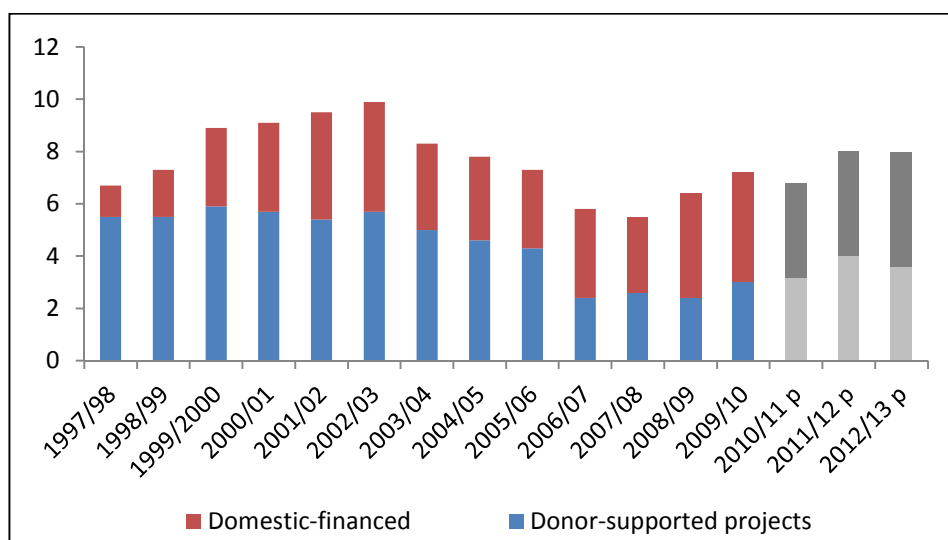
On the expenditure side, following significant increases in spending over the late 1990s and early 2000s, Ugandan authorities dramatically cut both development and current spending (as a share of GDP) over the mid-2000s (see figure 11 above). Between 1997/98 and 2001/02 government expenditure rose from 17 to almost 25 per cent of GDP. Of this increase, just under half was used for Poverty Action Fund expenditures (health, education etc.), while the remainder went on wage increases, defence and interest payments (International Monetary Fund 2003). Subsequently, development expenditures (both domestically and donor-financed projects) were almost halved between 2002/03 and 2007/08 (see figure 13).

And, while figure 13 indicates how development expenditures, most notably domestically-financed infrastructure expenditures, have increased lately, the total increase in development expenditures in GDP has been relatively modest and has to be seen against their strong decline (as a share of GDP) over the last decade (see also Section 3 above). Further, even though development expenditures are projected to increase as a share of GDP in the next few years, this increase fails to restore these expenditures to the shares of GDP attained in the early 2000s. It is against this trend that the strong rhetoric of increases in infrastructure has to be assessed, and the remarks made above regarding the centrality of the PPPs for the implementation of the ambitions of the National Development Plan to be borne in mind.

³¹ The national budget framework for FY2010/11-2014/15, for instance, indicates how (Ministry of Finance, Planning and Development 2010, p. 36): “oil revenues through the national budget will be invested in non-oil and non-gas sectors for productivity enhancement, such as, agro-processing and marketing, agricultural irrigation, water for production, roads, rail, other sources of energy and education and health infrastructure”.

³² “During the implementation of this plan, infrastructure for the oil and gas sector will be prioritised.” (Republic of Uganda 2010, April version, p. 49). See footnote 19 for more details.

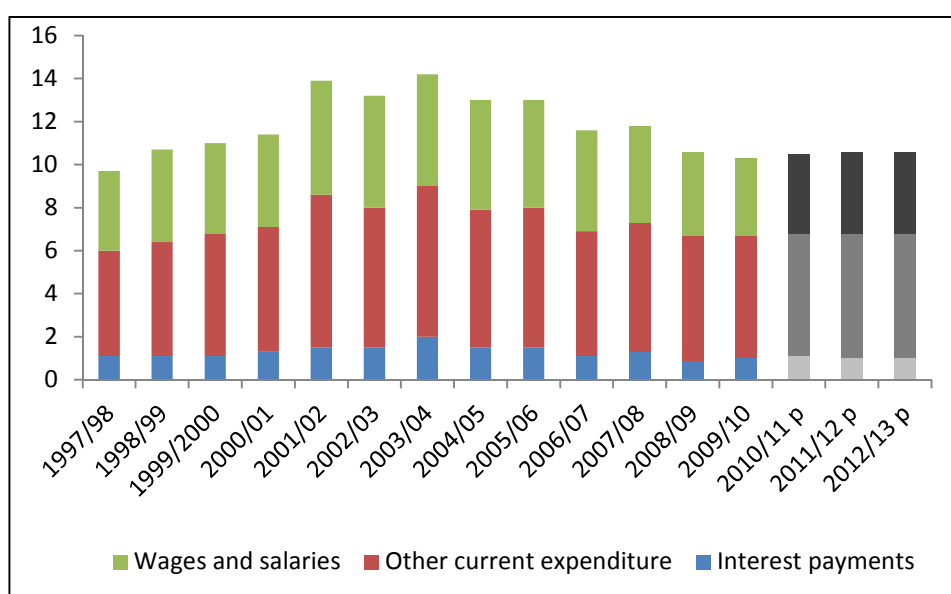
Figure 13. Uganda's Development Expenditures as a % of GDP (1997/98- 2012/13)



Source: IMF, Article IV Consultations, various years

Further, figure 14 below indicates how current government expenditures were cut by around a third over the mid-2000s, reaching their lowest level in ten years in 2009/10. The latest National Budget Framework Paper also indicates (MOFPED 2010, p. 32) that to create the necessary fiscal space for public investment in the critical areas identified in the National Development Plan, growth in recurrent spending will be curtailed. The “new” policy direction announced with the National Development Plan has hence not implied any departures from previous trends of downwards and constrained government expenditures. At most, some form of trade-off has occurred between development and recurrent spending to create the “fiscal space” for the much publicised infrastructure investments. This has implied cutting government consumption from 14 per cent of GDP in 2003/4 to 10 per cent, which is below government consumption expenditure as a share of GDP both in lower-middle income and high middle-income countries (where these are 13 per cent and 16 per cent respectively) (UNCTAD 2009, p. 48).

Figure 14. Uganda's Current Expenditures as a % of GDP (1997/98 – 2012/13)



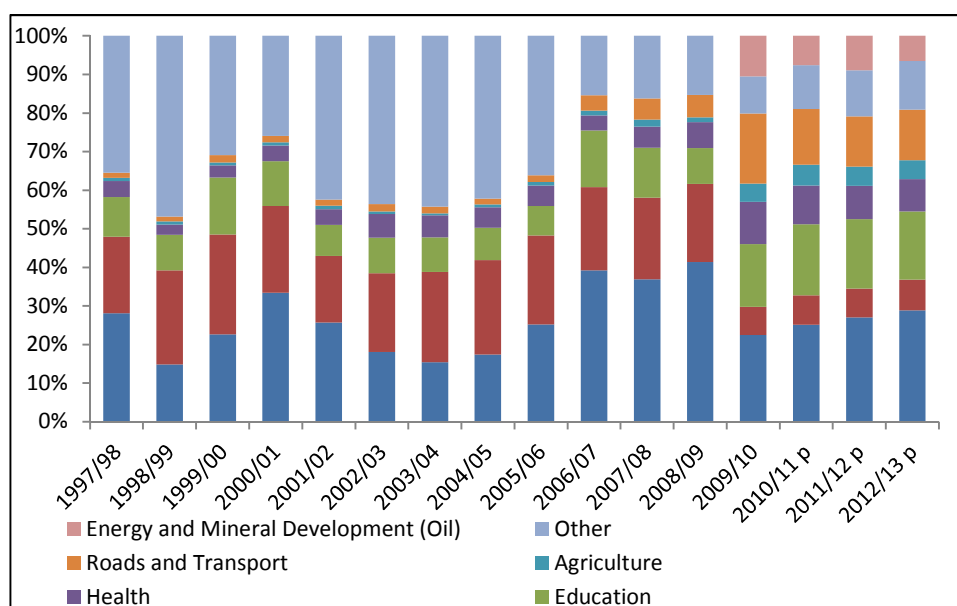
Source: IMF, Article IV Consultations, various years

The reliance on expenditure cuts rather than revenue mobilisation is a disappointing trend in Uganda. Rather than attempting to raise the revenue base through progressive taxation policies or operate with less constrained notions of fiscal space (see below), the burden of fiscal stringency has been on current and development expenditures. This has included cuts to wages and salaries, domestic and donor-financed projects with obvious repercussions for the employment and “decent work for all” agenda. The projections for increases in expenditure to meet the objectives of the NDP need therefore to be understood within this historic trajectory of wide-spread cuts, and projections for expenditure as a percentage of GDP for 2014/15 do not see a return to the expenditure levels of the early-2000s.

Figure 15 provides a sectoral picture of the government’s expenditures priorities. In recent years Uganda’s budgetary sector expenditures have been reoriented towards roads, infrastructure spending and energy and mineral development, away from other, non-priority sectors, including loan repayments and public order and safety. In line with the NDP, this reorientation of expenditures is targeted to continue in the near future, with defence spending set to reduce further. The budgetary allocations for education and agricultural budgets have also been targeted to increase. However, this reorientation of expenditures needs to be understood within the wider context of stagnant expenditures as a share of GDP (see above).

Worryingly, given that the agricultural sector employs around 75 per cent of the economically active population, this sector has consistently received less than 5 per cent of total (recurrent and development) expenditure over the last 10 years. In terms of public development expenditures on agriculture, Joughin and Kjaer (2010, p. 8) comment that “despite all the rhetoric...the share of funding for the sector (broadly defined including forestry and fisheries) has fallen from 8% in 2001/02 to 5.7% in 2005/06, to 4.1% in 2007/8, to 3.7% in 2008/9...” (Joughin and Kjoer 2010, p. 8). The 2009/10 budget, in line with the NDP, saw the sectoral share of agriculture in budgetary allocations increase to 4.5%, but this remains dramatically inadequate for the sector and significantly lower than in other low-income countries (Fan 2008).

Figure 15. Uganda’s Expenditure by Sector (percentage of total expenditure)



Source: UBOS, Statistical Abstracts (various years); MOFPED, 2010

The sectoral composition of government expenditures has an important impact on the structure of the Ugandan economy and employment creation. Fan (2008) points out that across a number of developing countries, reductions in spending in agriculture and other productive sectors have had detrimental consequences on development indicators, as these sectors have larger returns to GDP growth and poverty reduction than non-productive sectors. In the case of Uganda, this is somehow offset more recently with the emphasis on infrastructure.

Furthermore, there have been problems with the execution of the 2009/10 budget. This under-spending is mostly explained by significant under-execution of capital spending. This was partially due to problems with the introduction of new procurement procedures, which many line ministries lacked capacity to implement.³³ In this context, Sender and von Uexkull (2009, p. 19) observed:

Recently, Uganda has found it difficult to achieve even its planned rates of growth of capital expenditure ... the limited capacity to execute urgently needed rural infrastructure projects has become a matter of concern raised by the donor community. This capacity will need to be improved before it will be possible to implement the ... recommendations for labour-based infrastructure as a response to the long-term problem of inadequate employment opportunities.

Finally, the government's spending pattern has not been altered in response to the global crisis.³⁴ Inflation concerns drove the government's fiscal response, with the fear of worsening inflation driving the decision not to put in place a stimulus package (see also below). Fiscal policy remained steered by the desire of the authorities to maintain their fiscal target of reducing the deficit to below 5 per cent of GDP. Ssewanyana and Bategeka (2010, p. 14) comment as follows:

Broadly, like monetary policy, fiscal policy in Uganda remained largely conservative during the period, with no expressed policy to increase the size of the fiscal deficit. On the contrary, the fiscal authorities continued with their desire to decrease the fiscal deficit ... Yet, to address the adverse effects of the crisis, the country needed to increase public sector spending. This was repugnant to Uganda's monetary and fiscal authorities, which thought that such action would have long-lasting adverse effects on the economy through destabilisation of the macroeconomic environment.

6.2 Alternative fiscal policy options

As we have seen above, fiscal deficit levels in Uganda have been brought down quite strongly (see figure 10). One of the main reasons for Uganda's fiscal stringency in recent years has been a fear of the potential inflationary impact of fiscal deficits as well as fears of crowding-out private investment. It is argued that higher fiscal deficits, if financed through the issuing of government bonds, will lead to higher interest rates and therefore crowd-out private investment. Alternatively, financing higher deficits through borrowing from the central bank will lead to an increase in the money supply, which, it is

³³ Interviews with researchers (EPRC) and stakeholders (FUE) indicated widespread problems with the introduction of the new procurement guidelines. The processes involved are complicated, slow and require specialist knowledge. A lack of capacity within line ministries and on the part of Ugandan contractors results in delays in budget execution as well as attempts to circumvent the process altogether.

³⁴ During interview, however, we were often given the impression that an expansionary fiscal policy had been put in place in response to the crisis. The confusion probably results from the *reorientation* of public spending towards public infrastructure that took place in 2007 and continued thereafter. As pointed out in the text above, this has nevertheless happened against an underlying trend of fiscal consolidation (through lowering government expenditure).

argued, would feed through to higher inflation. In addition, if the increase in the money supply is used to increase imports, the current account deficit could worsen.

However, a number of studies indicate an alternative view on the relationship between fiscal deficits and inflation in countries with excess capacity (Epstein 2009; Weeks 2009; Muqtada 2010). In a country such as Uganda, where the economy is operating below its full potential, financing the deficit, whether through bond sales or monetisation need not result in inflation or crowding-out. If the increased expenditure is directed towards complimentary sectors, such as infrastructure, private investment will most likely be crowded-in. This has been consistently demonstrated across a host of developing countries.

In relation to the potential crowding out effect of higher fiscal deficits, Weeks (2009, p. 6) highlights:

The specific hypothesis that raising resources, either through taxation or borrowing, reduces, i.e., 'crowds out', private sector investment is an empirical question about which no general conclusion can be drawn. Economic theory tells one that this will occur when an economy is constrained by a scarce resource, and the public sector expenditure competes with the private sector for access to that resource. If there is general under-utilisation of resources, as is the case in most African countries, resources are not scarce in the technical sense, and 'crowding out' will not occur. Indeed, the opposite is likely: public expenditures, by raising demand or being directly complementary to private investment, can 'crowd-in' private spending directly or indirectly via aggregate demand.

This perspective is supported by a number of policy makers and stakeholders in Uganda, who feel that current deficit levels and future projections are too conservative. Most recently, Ssewanyana and Bategeka (2010, pp.14-15) strongly reiterate the main arguments in favour of increasing deficit levels in Uganda:

While we appreciate Uganda's increased public sector investment in infrastructure development ... the infrastructure deficit that the country must meet to realise its development aspirations remains enormous, calling for an increase in the size of the fiscal deficit. The issue should not be the size of the fiscal deficit but rather the way it is financed and how the money is spent. The relevant question to address should be: could the benefits of a relatively larger deficit be more than the costs in the medium to long term? If the answer is yes, then the Ugandan authorities should go for a larger deficit than the current target of less than 5% of GDP. It is important to recognise that, in the short run, the binding constraints to the country's economic growth and development need to be removed to foster economic growth and transformation. Uganda is unlikely to register higher inflation just because of a wider fiscal deficit, mainly for the following two reasons:

- High demand for imported inputs for the development of public infrastructure; some of the inputs could be sourced from abroad with little impact on monetary expansion in the domestic economy. Construction of hydropower dams and the railway network provide good examples of inputs that the country could spend on without increased risk of sustained moderate inflation.
- The Ugandan economy is operating at below full employment, calling for a stimulus package to increase resource allocation and utilisation, employment and capacity utilization.

Ultimately, the ability of a government to implement more growth-inducing macroeconomic policies depends on its fiscal space, i.e. its ability to raise revenue and rely on debt instruments or external grants for financing (see UNCTAD 2009). It has been repeatedly emphasised in the literature that running deficits can be justified, in general, on two major counts. First, government expenditures can be used to compensate

for falls in private spending during economic downturns. Second, running deficits is fully justified, even in non-recessionary periods, to support public investment (Weeks and McKinley 2007). This is the development rationale for running a deficit. Indeed, Weeks and McKinley (2007) insist that it makes little sense to use current revenues to finance public investment since the additional future revenues expected from the investment should pay off the debt that the government initially incurred. It is through this development function that public investment can stimulate private investment and boost economy-wide labour productivity (see UNCTAD 2009).

In the case of Uganda, although the deficit position seems to be constrained by the government's commitment to the EAC convergence criteria (a fiscal deficit below 5 per cent of GDP), it may be worth recalling that the country has a low debt-to-GDP ratio, which declined from 69 per cent of GDP in 2004 to 29 per cent in 2008 (ODI 2010).³⁵ This is well below the (arbitrary) benchmark of 40 per cent often referred to by the IMF for developing countries. It indicates the possibility of **increasing the deficit**. This would ideally be done by recourse to external concessional or grant financing but could also happen through raising domestic debt.³⁶ Indeed, and as has already pointed out above, the basic rationale for running public deficits to finance public investment is that the future rate of return on such investment would pay off the debt.

Recently Chowdury and Islam (2010) have again reminded us that the “current preoccupation with identifying prudential limits on public debt-to-GDP ratios have had the consequence of distracting attention from the crucial role that fiscal policy plays in promoting growth and development”. The authors insist that the relationship between the debt-to-GDP ratio and macroeconomic instability is weak and provide a convincing argument to move beyond the imposition of financial straightjackets implied by conformity to alleged “optimal” debt-GDP ratios in favour of publicly-financed (or deficit-financed) investment to stimulate growth.³⁷

Further, a public investment programme needs to be combined with **specific labour market and employment policies**. Given the importance of projected public private partnership at the heart of the various investment programmes proposed in the National Development Plan, there is a need for a legal framework on procurement that allows for labour-based clauses to be imposed on private investors.³⁸ In this regard, Sender and von Uexkull (2009, p. 68) recommend that:³⁹

³⁵ It could be noted that despite this reality of a low public debt-to-GDP ratio, myths regarding “high debt-to-GDP ratios” in Uganda abound. An initial assessment of fiscal policy in the wake of the global crisis, for instance, asserted that: “given the high debt to GDP ratio, Uganda’s expenditure should be well targeted” (Ssewanyana et al. 2009, p. 18).

³⁶ A host of issues may be argued to interfere with the mechanism whereby the government issues bonds to finance long term investment, not in the least the biased asset holdings within the commercial banking sector with possible implications for credit extension towards the private sector (see the section on monetary policy below). However, there are ways to overcome such constraints, for instance, through excluding the commercial banks from government bond auctions, or/and to let the government function as “investor of last resort”, if private sector investment is not forthcoming. See also Ssewanyana et al. (2009, p. 17), who make an argument in favour of excluding commercial banks from the primary market of the government’s short-term debt instruments (Treasury Bills).

³⁷ The authors add that liquidity concerns do not strictly apply in the case of domestic debt, “which can always be paid off by printing money, a sovereign right which households or firms do not have”.

³⁸ We have seen a draft of a Local Construction Industry Policy which includes a clause on labour based work (8f in

labour-based construction methods are universally adopted; that the number of additional days of employment, as well as their distribution between males and females and richer and poorer rural households, is closely monitored; and the wage rates are set low enough so that the poorest are self-selected into the new opportunities for temporary wage employment in the construction sector. Government agencies should also insist that the use of labour-based construction methods is a condition for the (re-)awarding of contracts for rural infrastructure provision.

The authors add that “the planned programme of investment to improve the physical and social infrastructure in rural areas and to increase agricultural production presents an excellent opportunity to tighten the labour market for poorly educated rural workers. However, the employment creation aspects need to be very much more carefully planned and monitored”.

There have also been some indications from interviewees that many private sector firms have not adopted employment policies that favour Ugandan workers. In the first instance, a number of multinational firms do not recognise trade unions, weakening the bargaining position of the latter. Secondly, international firms are often able to hire workers from overseas, arguing that the skills of Ugandan workers are not adapted to their industry. Given these concerns, the public sector in Uganda may have greater purchase to see through policies that combine the implementation of the National Development Plan with employment generation, through, for example, public works schemes.

Finally, alternative directions in fiscal policy crucially depend on **improved domestic revenue mobilisation efforts**. We saw previously, that Uganda has relied on spending cuts over revenue mobilisation to meet its fiscal targets. In fact, attempts at raising domestic revenue have been disappointing. Domestic revenue remains under 12 per cent of GDP in Uganda, well below average domestic revenue mobilisation efforts in low-income countries and lower than average for sub-Saharan Africa as a whole (see table 2). Crucially, other than a one-off increase in tax revenue as a percentage of GDP between 2001 and 2002, the picture on revenue mobilisation has remained stagnant (see figure 12 above).

Table 2. Uganda’s Revenue Performance in Perspective

Years	LIC Total Revenue Averages	Sub-Saharan African LICs Total Revenue Averages	Uganda Total Revenue Averages
1990-1994	13.3	13.3	9.1
1995-1999	16.1	14.1	11.3
2000-2006	18.2	15.6	12.9

Source: IMF, Article IV Consultations, various years

Uganda therefore has scope to increase its revenue efforts by expanding the tax base and by implementing progressive tax policies that ensure the rich are taxed more heavily

<http://www.uace.or.ug/index.php?option=displaypage&Itemid=70&op=page&SubMenu=>), but it remained uncertain to us whether this was a bill that has been adopted, and if so, to what extent it is implemented and what kind of enforcement mechanisms exist.

³⁹ See also Ministry of Gender, Labour and Social Development (2010, p. 18) quoted in the closing paragraph of Section 4 above.

than poor workers (Gottschalk 2008). Further, the discovery of oil represents an opportunity for Uganda to raise domestic revenues in the future. However, McKinley and Kyrili (2009) underscore the importance for low-income countries in general to build their capacity to negotiate effectively with multinational corporations in order to secure an equitable public share of resource rents.

More specifically, attempts to enhance the state's revenue raising capacity could include the following measures.⁴⁰ In Uganda, where a standard rate of VAT at 18 per cent prevails, VAT could be increased on luxury consumption items. Such a measure would also address the regressive nature of a standard VAT rate across consumption goods. Income taxes, currently operating with a flat rate scale, could be made progressive. Tax holidays and exemptions for corporations should be reduced, and cuts in corporate taxes should be resisted. The latter issue has to some extent been acknowledged recently by Ugandan Ministry of FPED, with the most recent National Budget Framework Paper stating the following (Ministry of Finance, Planning and Development 2010, p. 33):

In a bid to attract investment there is pressure to grant tax incentives. This trend is likely to undermine the tax revenue mobilization effort. All the tax laws already incorporate generous tax incentives comparable to other credible tax jurisdictions. For example, the Income Tax Act provides for initial allowances, accelerated depreciation, indefinite loss carryover and various deductions on capital expenditure. Under the VAT Act, Investment Traders are entitled to VAT deferment on their capital investment. Plant and machinery, essential raw materials and spare parts do not attract import taxes. There is therefore need to review the tax incentives policy to minimize waste.

A recent report by the African Development Bank (ADB 2010, p. viii) notes that tax revenue as a percentage of GDP in Uganda could easily go up to 16 per cent (from the current rate of 12 per cent) if some of the revenue negating measures, particularly incentives and exemptions, were removed. Di John (2008) also argues that the common policy in developing countries of exempting high-income earning expatriate residents from paying income taxes should be reconsidered, which in itself creates a poor demonstration effect for high-income earning nationals.

Further, urban property taxes remain often underdeveloped in low-income countries as an avenue for revenue collection. In line with this, Matovu (2010) argues for the introduction of a property tax in Uganda to be levied on commercial and residential properties and to be used to finance local government development programmes. Di John (2008) points to a set of reasons why governments, especially at local levels should focus on this tax. It could provide financing for urban infrastructure investment, which would improve production and export capacity of light manufacturing plants, often located in urban centres. Further, urban property taxes could be levied by municipal governments, who, with the extensive decentralisation exercises that have been pursued in poor countries (including Uganda) have become increasingly responsible for public service delivery without necessarily having been allocated the necessary resources to do so. Urban property tax reform has been relatively absent from the policy agenda in developing countries as donor-led reforms of taxation (with an important role played the IMF) have focused on national tax efforts and because an urban property tax scheme

⁴⁰ It needs to be observed, however, that for improved tax collection to enhance the growth prospects of the economy, policies should be pursued that aim to translate improved revenue generation into the construction of productive capacities. Improved tax collection in the absence of the latter is not likely to accelerate domestic accumulation rates and may even damage growth prospects (see Di John 2008).

requires investment in capacity (often neglected in the presence of the availability of the quick-fix solutions such as VAT).

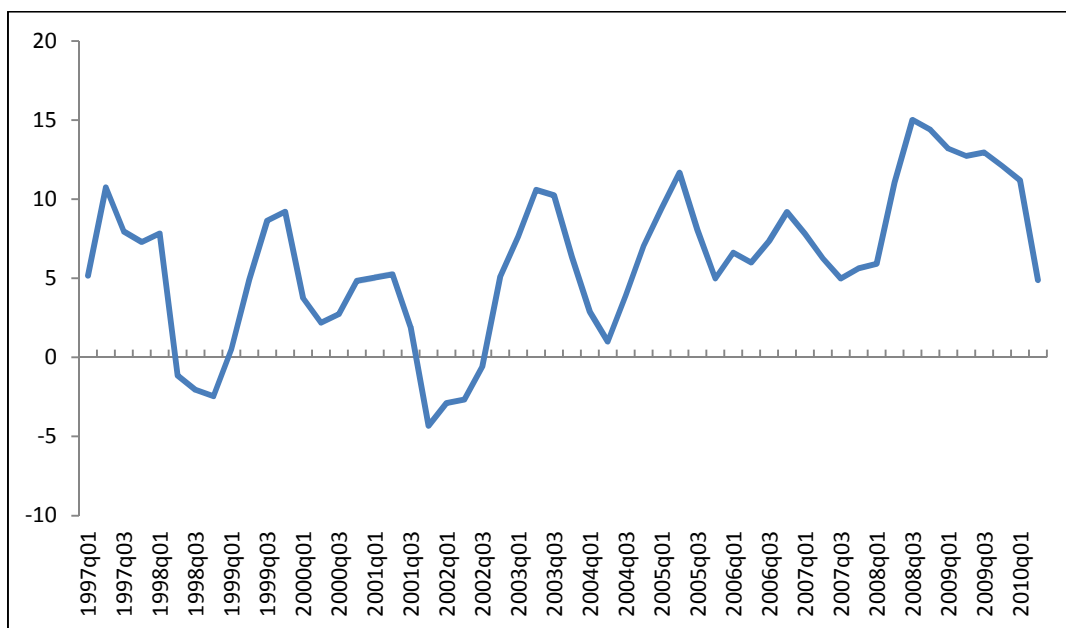
A set of structural impediments is often identified as limiting the possibility of raising tax revenues in low-income countries, such as Uganda. These typically include the existence of a large informal sector and a small share of wages in national income. The issue of informality could potentially be addressed through the provision of specific incentives to businesses that fear loss of income as a result of taxation once part of the formal economy. Such incentives could include upgraded infrastructure, support for marketing and distribution as well as access to credit. This implies that attempting to bring the informal sector into the taxable realm requires linking tax policy to domestic production strategies.

6.3 Monetary policy

The Bank of Uganda’s official mission is to ensure macroeconomic stability, mainly understood as price stability. The main aim of monetary policy, hence, is to maintain “low and stable inflation”. Since 1993, the Reserve Money Programme has guided the conduct of monetary policy in Uganda, guided itself by the medium-term goal of keeping inflation below 5 per cent. This was reasserted recently in the wake of the crisis (Bank of Uganda 2010b, p. 2): “Monetary policy remains geared towards reducing annual core inflation to its long term target of 5 per cent while at the same time providing sufficient liquidity to allow aggregate demand to strengthen.”

Figure 16 illustrates that Uganda’s inflation rate has been moderate to low over the last 10 to 15 years. It was brought down rapidly from 66 per cent in 1992. Inflation has mainly remained below 10% and on two occasions in recent years (1998 and 2002) has fallen below zero. Uganda’s CPI basket is dominated by food, rent, fuel and utility prices, making up almost half of the total consumption basket (UBOS 2009). The steep rise in food and fuel costs starting in 2008 helps to explain the rise in inflation over the course of 2008 and 2009 in Uganda.

Figure 16. Inflation in Uganda: Consumer Price Index % Change (quarterly data)



Source: International Financial Statistics, IMF

The conduct of monetary policy by the Bank of Uganda is done on the basis of a target for reserve money growth and relies on a set of instruments to effect this target. These include: open-market type operations through Treasury bills, BOU bills and repurchase agreements;⁴¹ cash reserve requirements on all deposit liabilities; a Bank rate to regulate commercial bank's borrowing from BOU; a rediscount rate to address any liquidity shortages; and spot interventions in the foreign-exchange market (see Musinguzi and Katarikawi 2001).

Kasekende and Brownbridge (2010, p. 5) note, however, that in monetary targeting regimes, interest rates often play a secondary, if any, role as policy tool: "What are termed 'policy rates' in money targeting regimes are either determined endogenously, through a link to a market interest rate such as a Treasury Bill rate or are not binding in the sense that they do not influence interest rates in financial markets".

The analytical and programmatic framework underlying Uganda's monetary policy is the IMF's Financial Programming framework, which generates ceilings on net domestic assets and floors on international reserves. Epstein and Heintz (2006) reiterate how the IMF's financial programming approach implies an intrinsic highly contractionary bias to monetary policy.⁴² This is combined with informal inflation targeting, adding an additional constraint on monetary policy. During interview with government officials, our attention was also drawn to the failure to consider labour market outcomes in this model, and the model's implication that the link between the macroeconomic variables and growth remains tenuous, with the latter serving merely as a target rather than that its specific dynamics are linked to (or inform) supporting macroeconomic policies.⁴³

Even most recently, during the food, fuel and financial crisis, the monetary authorities have remained committed to chasing their low inflation target, despite clear evidence that increases in inflation were driven by food and fuel price increases (i.e. supply rather than demand factors). Ssewanyana and Bategeka (2010, p. 14) argue that this conservative monetary stance persisted despite calls from the international community for the BOU to ease its monetary policy.

The choice of monetary policy and related instruments in Uganda has increasingly come under question for their efficacy and potentially damaging effects (Epstein and Heintz 2006; Adam 2009; Kasekende and Brownbridge 2010). Given Uganda's open capital account and continued reliance on donor aid, a number of concerns have been raised about Uganda's choice of instruments. Furthermore, the conduct of monetary policy may have damaging consequences for Uganda's ability to implement an employment-oriented development path.

With significant parts of Uganda's budget financed by aid flows (30 per cent in 2008), the Bank of Uganda has often undertaken sterilisation efforts out of fear that the aid-infused liquidity (often spent on non-traded goods and services) may provoke

⁴¹ Of the three types of open market operations, the Treasury Bill is the most commonly used. The BOU decides on the size of the offer and lets the market determine the interest rate. The Treasury Bill is used solely as a monetary policy instrument and is rarely used to finance government expenditures.

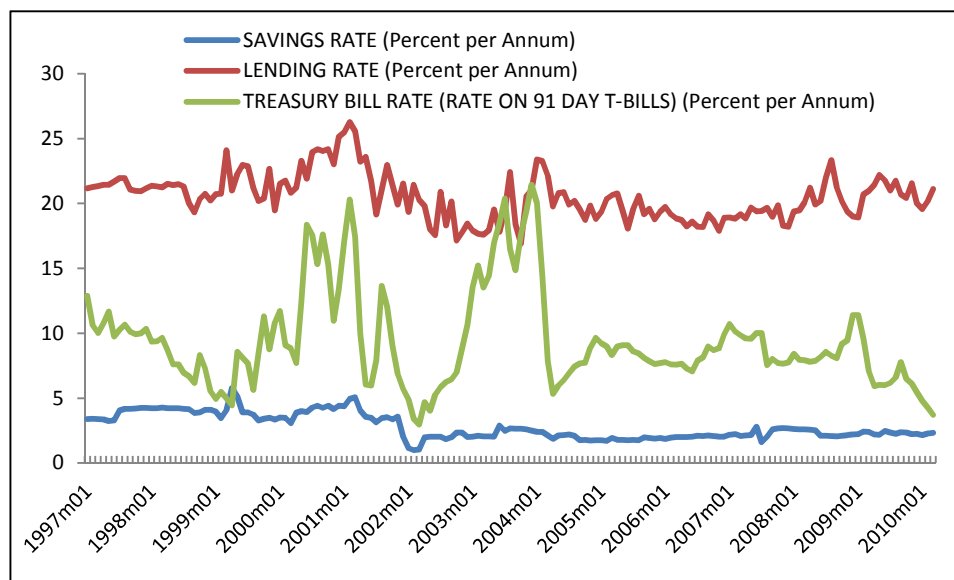
⁴² It is worth noting that, since 2005, the BoU has nearly every year outperformed on IMF programmed targets (in terms of ceilings on net domestic assets and floors on international reserves) (IMF various).

⁴³ It is also telling that during interview with a World Bank official at the Bank's Kampala office, the interviewee insisted that employment is not a macro issue but needs to be addressed solely through micro-level interventions.

inflationary pressures. In its operations to sterilise large inflows of donor aid (or large portfolio flows), sales of treasury bills may put undue pressure on the domestic interest rate. This was the case in 1999 and 2003, when large inflows of donor aid were accompanied by a surge of private capital leading to an appreciation in the real exchange rate. The Ugandan authorities responded promptly by purchasing foreign exchange (to lean against the appreciation of the currency) and issuing a large number of Treasury bills to mop up the liquidity infused through the purchase of foreign currency (International Monetary Fund 2003). The sterilisation effort pushed domestic interest rates up excessively and a strong deflationary pressure pushed the CPI well below its target. It was not considered that in conditions of idle capacity, infused liquidity need not result in inflation, but rather can stimulate the economy through increasing demand.⁴⁴

Ugandan monetary policy is further hampered by weak transmission mechanisms between its main instrument (open market transactions in Treasury bills) and lending rates in the economy mainly due to the underdevelopment of the domestic bond market, which coexists with high concentration in, the financial sector.⁴⁵ Figure 17 illustrates the wide discrepancy between the Treasury bill rate and lending rates in the Ugandan economy over the last decade.

Figure 17. Savings, Lending and Treasury Bill Rates in Uganda (1997-2010)



Source: International Financial Statistics, IMF

⁴⁴ Kasekende and Brownbridge (2010, p. 6) however argue that at points, the approach by the BoU has been more flexible, where the Bank responded to strong inflows of foreign exchange (from aid and capital inflows) by accumulating international reserves beyond planned targets to stem the appreciation of the exchange rate, and by allowing monetary growth to rise above targeted levels “in order to avoid having to fully sterilise the inflows of foreign exchange by issuing domestic securities, which could crowd out bank lending to the private sector”.

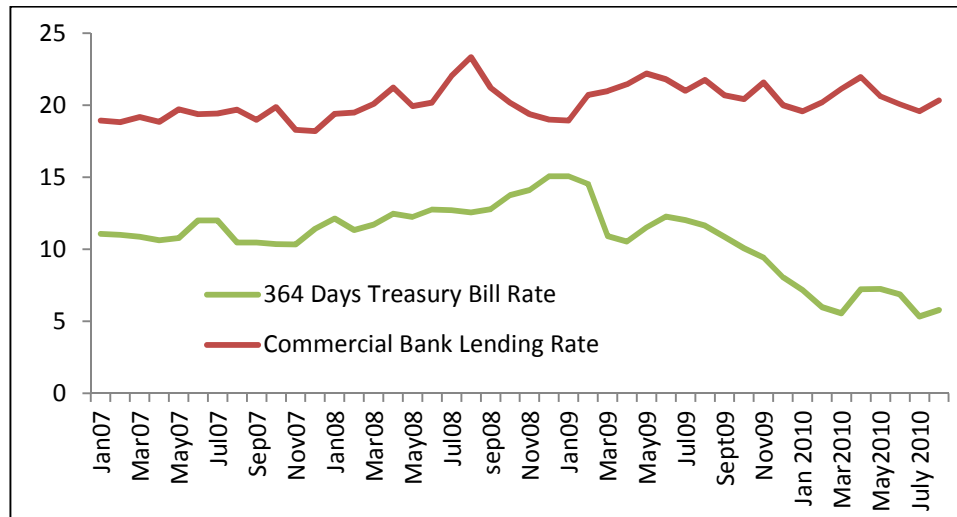
⁴⁵ See UNCTAD (2009, pp. 78-79) for a general argument on why monetary policy tends to be ineffective in LICs. A Central Bank tries to conduct monetary policy by buying and selling bonds and by acting as a price setter, through its policy interest rate. “For this activity to be effective, a viable market for public bonds must exist. Even in the most developed countries, relatively few households own bonds. In general, the vast majority of bonds are held by private banks and corporations ... Hence, an efficient bond market – the necessary prerequisite for an effective monetary policy – requires a burgeoning financial and corporate sector. Least Developed Countries (LDCs), however, do not have these sectors ... In LDCs, the banks (even if they are nationally owned), corporations, and wealthy households will not, taken together, create the basis for an efficient bond market”.

Figure 17 demonstrates the continuing divergence between lending and savings rates in Uganda, as well as the high volatility of Treasury bill rates, especially between 1999 and 2004. While in neighbouring countries spreads have come down (International Monetary Fund 2005; Kasekende and Brownbridge 2010), in Uganda the problem has worsened since 2009. High interest rates have made it difficult for domestic business to access affordable credit for investment. The high cost of credit represents a major constraint for many Ugandan investors, large and small. As a result firms are reluctant to take advantage of investment opportunities that could lead to employment generation through borrowing. This concern was repeatedly voiced by social partners and government officials during interview, and was probably the single most recurring issue we encountered during interviews.

Figure 18 further illustrates how, despite the lowering of Treasury bill rates over the course of 2009 and 2010, the commercial bank lending rate in Uganda has remained unchanged. Kasakende and Brownbridge (2010, p. 13) argue that “(t)he stickiness of bank lending rates is probably attributable to credit rationing by banks on the basis of borrower creditworthiness (so that there is excess demand for bank credit) and lack of competition in the banking industry”.

In Uganda, the three largest banks “account for approximately 70 per cent of the total financial assets under management. Combined with the illiquidity in the market, this high concentration sustains wide net interest margins and relatively low lending to the private sector” (Adam 2009, p. 10). During interviews the excessive concentration in the banking sector was often highlighted as a particularly pernicious feature of Uganda’s financial environment.

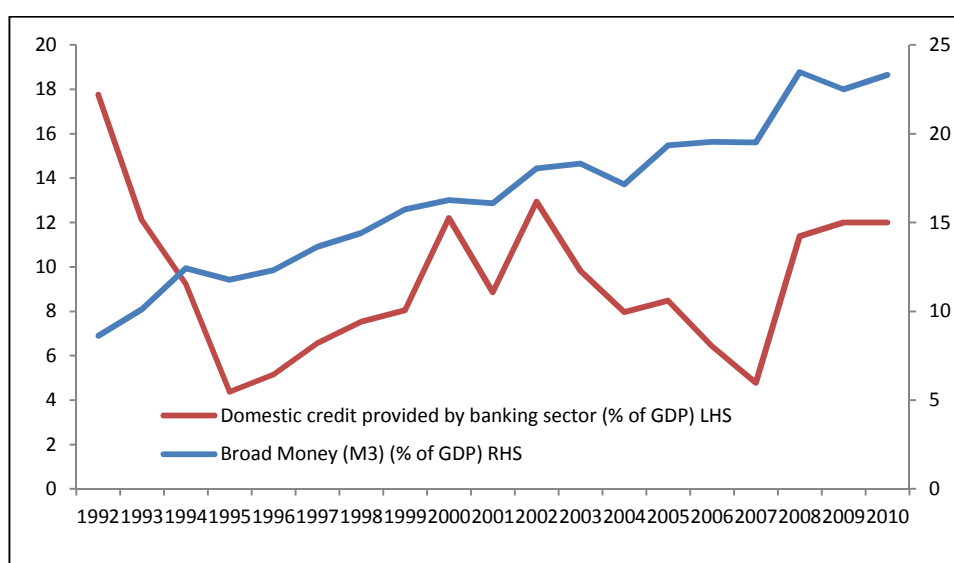
Figure 18. 364-day TB rate and average bank lending rates in Uganda, 01/2007-06/ 2010



Source: Bank of Uganda

Developments in Uganda’s financial and banking markets over recent years, hence, need to be considered closely when assessing the efficacy of monetary policy and its consequences for objectives of employment creation and structural change. While in aggregate terms we can see significant financial deepening in Uganda (as shown by the growth in broad money in figure 19), this has not translated into a steady growth in the provision of domestic credit by the banking sector.

Figure 19. Broad money (M3) and domestic credit growth in Uganda



Source: Bank of Uganda and World Development Indicators, World Bank

Instead, holdings of government securities by commercial banks rose dramatically over the 1990s before stabilising at around 6 per cent of GDP. This translates into government securities representing today, on average, 20 per cent of commercial banks assets.⁴⁶ This situation also prevails in other sub-Saharan African contexts (Epstein and Heintz, 2006). The failure to provide long-term credit to the private sector is also reflected in the maturity structure of loans made by commercial banks. In 2004, only 12 per cent of total loans had a maturity of longer than one year (International Monetary Fund 2005).

Interviews with policy stakeholders supported the above observations regarding the behaviour of commercial banks in Uganda. Researchers and policy-makers at MOFPED and the BoU confirmed the lack of lending by commercial banks to the domestic private sector in Uganda, with banks favouring short-term and less risky government treasury bills over long-term loans to domestic industry. Private sector representatives also confirmed the lack of affordable credit available to their members, stifling the ability of the latter to invest and expand capital and labour opportunities.⁴⁷ It was also observed during interview that the global financial crisis may have worsened this situation by making commercial banks even more risk averse, hence worsening credit rationing. This is borne out by the facts. The Financial Stability Report of the BOU (2010a, p. 14) indicates how in the two years preceding June 2010 a significant slowdown in credit growth took place “as banks focused on repairing loan books.”⁴⁸ It may also be observed that, at least until May 2009, the Ugandan corporate non-financial sector was a net creditor to the banking system (Masha 2009, p. 12).

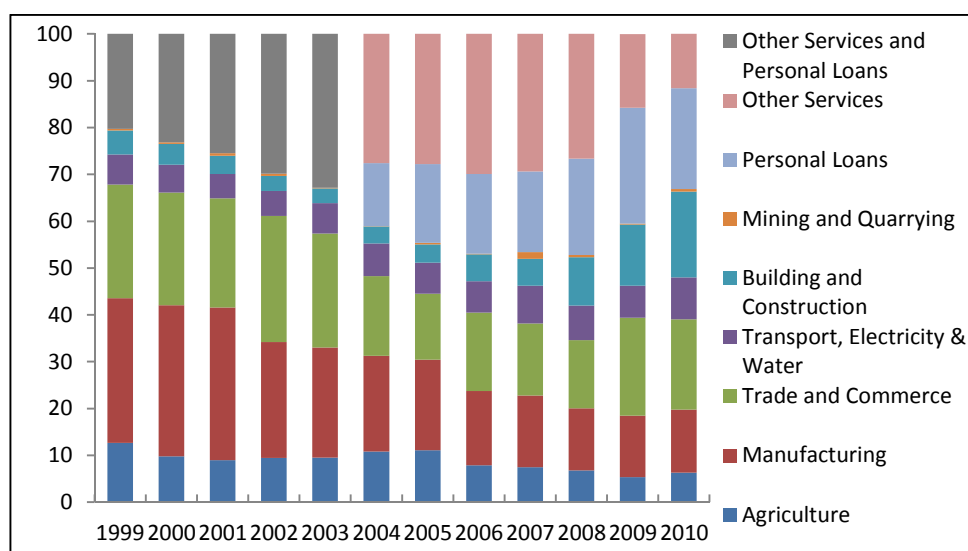
⁴⁶ Statutory cash deposits at the BOU represent 10.7 per cent of total bank assets; loans and advances 41.9 per cent of total assets; with the rest accounted for by activities in money markets (locally and abroad) (Masha 2009).

⁴⁷ Current initiatives to help rectify these problems include the recapitalisation of the Uganda Development Bank (UDB); the introduction of a tri-partite Agricultural Credit Facility; and the establishment of a Credit Reference Bureau. However, according to discussions with stakeholders in Uganda these initiatives have so far not borne fruit and led to greater private sector credit access. See the policy options section below for further discussion.

⁴⁸ Sender and von Uexkull (2009, p. 23) also reported how some of the companies they interviewed stated that access to credit from domestic banks had become more restrictive in 2009 as banks perceived higher risks in their portfolios.

Figure 20 provides a sectoral decomposition of private sector lending and displays a further worrying trend regarding credit provisioning in Uganda. As a share of total credit to the private sector, the manufacturing and agricultural sectors have steadily diminished since 1999. Together these sectors made up 43.6% of loans to the private sector in 1999, but in 2010 only accounted for 19.7% of total lending. The failure of these sectors to access affordable credit may help to explain the lack of investment growth and expansion of decent work opportunities.

Figure 20. Sectoral shares of credit to the private sector (% of the total lending)



Source: Research Department, Bank of Uganda.

Loans to less risky sectors with strong collateral, such as the building and construction sectors as well as personal loans, and in the last two years trade and commerce, have, nevertheless, increased their shares. For example, the building and construction sectors have increased their share in total lending from under 6% of total lending in 2007 to over 18% in 2010. The Bank of Uganda’s recent Financial Stability Report echoes these developments: “Banks increased their mortgage lending in 2009/10, especially for commercial projects. Between June 2009 and June 2010, total mortgages jumped from US\$ 386 billion to US\$ 513 billion, a rise of 33 per cent” (Bank of Uganda 2010a, p. 14).

The banking system in Uganda is therefore geared towards extending a limited amount of high cost, short-term credit rather than long-term investment mobilisation in sectors where employment could be generated. However, it is important to remember that access to credit alone will not generate a surge in investment in productive sectors. Providing access to credit is therefore necessary, but not sufficient, for improving employment outcomes in Uganda.

6.4 Monetary and financial policy options for Uganda

It was illustrated above that monetary policy in Uganda remains dominated by the restrictive policy imperative of trying to keep the inflation rate below 5 per cent. This has important implications for monetary and financial conditions in the country. In guise of alternative to this restrictive framework, Saad-Filho (2007) outlines the objectives of monetary policy as supporting fiscal and exchange rate policies while ensuring the inflation levels do not reach excessively high or low levels. Rather than exclusively focusing on price stability, monetary and financial policies should help to restructure the economy through strategic credit allocation to priority sectors and by keeping interest

rates supportively low and stable, apart from providing sufficient liquidity for a growing economy (Epstein and Grabel 2007). This would allow employment targets to become part and parcel of monetary policy making.

It can be argued that the objective of monetary policy should be to support fiscal policy and to provide a stable investment- and employment-inducing environment. In this respect maintaining low and stable interest rates is a crucial element of employment-supportive monetary policy (Saad-Filho 2007). In the Ugandan context there is clearly an urgent need to bring down interest rates (see earlier discussion). Mechanisms also need to be devised to foster better credit provisioning. The economy is characterised by excess capacity (idle capacity in manufacturing coexists with significant un- and underemployment) and increases in liquidity are unlikely to generate important inflationary pressures.

A further consideration when addressing inflation in a country such as Uganda must be its causes and drivers. Unlike in more developed economies, the driving forces of inflation are often rooted in structural/ supply constraints rather than demand pressures. These structural drivers include infrastructural bottlenecks, which can push up costs and, often, the price of wage goods such as food. Policies that confront such structural root-causes of inflation will need to tackle supply constraints and may have important linkages to greater employment creation in the short to medium term. Ssewanyana and Bategeka (2010, p. 14) observe: “(t)o look at inflation as ‘always and everywhere a monetary phenomena’, as the Uganda monetary authorities chose to do, falls short of appreciating the extent to which increased supply of goods and services would have a mitigating effect on inflation”.

Recently, the surge in inflation in a number of low-income countries was triggered by the food and fuel price hikes, which themselves had a host of causes, including global financial deregulation and the entry of new players onto the commodity exchanges (see Ghosh 2010). In low-income countries, sharp exchange rate movements (depreciations) also often have important implications for inflation, especially when imports are characterised by low price elasticities. This draws attention to the importance of exchange rate management, to which we return below.

A more expansionary monetary policy may help to bring down interest rates and thereby assist some struggling businesses to access credit at a reduced rate. However, given the large interest rate spreads seen in Uganda today, it is not clear that the lower interest rates will be passed on to consumers and businesses through commercial banks. This will be particularly the case in some industries and sectors (such as agriculture) in which risks are thought to be too great and collateral not readily available.

In Uganda the government has attempted to help with respect to **credit access** through three recent initiatives: the Agricultural Credit Facility, the Credit Reference Bureau and the Uganda Development Bank.

The first of these, the Agricultural Credit Facility, is a tri-partite facility that was set up in 2009/10 and is aimed at increasing credit access for rural areas. The Agricultural Credit Facility was allocated US\$30bn (US\$15m) by central government, which was to be supplemented by another US\$30bn (US\$15m) by participating financial and credit institutions. Indications from interviews with government officials and private sector leaders in Uganda are that the Agricultural Credit Facility remains problematic. In the first instance the funds made available are insufficient for the demand within the agricultural sector. Secondly, commercial banks are reluctant to disburse loans under the Agricultural Credit Facility as this competes with their more commercial loans. Finally,

there is a persistent perception among the private sector that allocation of these funds is politically and not economically driven.

The Credit Reference Bureau is another recent initiative set up in 2009 with the purpose of disseminating credit information among financial institutions in the hope that this will “improve the performance of Uganda’s financial sector and stimulate economic development by making lending and borrowing easier, faster, and ultimately cheaper” (Tumusiime-Mutebile 2008). However, to date, benefits in terms of lower interest rates and greater private sector credit provisioning have not been forthcoming.

The final recent initiative to assist private sector businesses in accessing credit has been the recapitalisation of the Uganda Development Bank (UDB). The UDB was originally set up in 1972 with the remit to empower local businesses and finance large construction projects. The UDB shifted its lending portfolio somewhat over the early 1990s, increasingly lending to small and medium enterprises. Partially as a result of this shift in lending towards smaller businesses, the UDB experienced balance sheet problems and the lending services of the bank were disbanded in 1997. Despite opposition from the World Bank and IMF (International Monetary Fund and International Development Association 2010), UDB was recapitalised over the 2000s and started lending again in 2008.⁴⁹

The Ugandan Government remains a 100 per cent shareholder of the UDB and funds have been obtained from a number of overseas donors to assist the recapitalisation efforts. According to the UDB’s website, the bank can extend loans to “viable projects in the country’s key economic sectors.... Emphasis is placed on projects, which have the capacity to spur more development. The key sectors which UDB finances include agriculture, health, infrastructure, trade, tourism, education, export promotion, industrial development, manufacturing, and processing” (<http://www.udbl.co.ug>).

The reinstated UDB only began lending operations anew in 2008. Getting a clear sense of its success is therefore somewhat premature. However, from interviews with UDB managers and other stakeholders it is clear that UDB is not yet integrated into a wider Ugandan development, employment or sectoral strategy. During interviews, the concern was expressed that the operations of the UDB are insufficiently integrated with a strategic vision of development and that its operations remained focussed on micro-finance for small and medium enterprises rather than being used for larger-scale projects with an emphasis on agricultural and manufacturing development. Furthermore, while intentions are to extend credit to the agricultural sector, this only made up 15% of the bank’s loan portfolio in 2009. Finding ways of financing this sector therefore remains a challenge.

While the recapitalisation of the UDB is to be welcomed, from an employment perspective it is crucial that this institution plays a critical role within a broader sectoral and employment strategy in Uganda. Rather than extending loans on a purely commercial basis, as the bank currently does, assessments based on direct and indirect employment-generation should also be considered.

⁴⁹ The recapitalisation of the UDB has been met with great scepticism, if not outright disapproval, from the donor community. This was explicitly expressed by a World Bank official (Kampala office) during interview. In counterpoint, it is worth quoting Chang and Grabel (2004, pp. 280-1): “The challenges of effectively managing [development banks] are neither greater nor less than those associated with managing private banks in a liberalised environment”.

Finally, we consider the possibilities of employment-oriented financial and investment policies. Pollin et al. (2006) outline a plan for the South African economy in which **subsidised credit** is directed toward viable businesses that will expand employment. In this plan companies and organisations that apply for such subsidised credit must demonstrate that this credit will either be used in social priority sectors or the project needs to demonstrate large positive employment effects. As such, to apply for a loan under this programme, a firm “would have to provide an employment impact statement demonstrating the overall number of jobs to be created by its investment. The employment impact statement should include both the direct and indirect job effects of the project to be financed by the loan” (Epstein and Gabel 2007, p. 22).

A similar plan could be implemented in Uganda. The recapitalisation of the Uganda Development Bank and the plans for economic restructuring set out in the National Development Plan provide a starting-point for such initiatives to be put into action. Given the government’s commitment to increased investments in the infrastructure and agribusiness sectors in Uganda (Republic of Uganda 2010), these sectors are particularly well suited for employment-targeting investment policies. It goes without saying that such a policy would require close monitoring and the setting up of a system of rewards and penalties, as outlined by Pollin et al. (2006) for South Africa.

Pollin et al (2006) outline how recipients of subsidised credit would need to, in the first instance, produce an employment impact statement against which they are assessed over the course of their receipt of the subsidised loan. Three types of monitoring systems are then outlined to ensure the stated employment targets are met. The first involves the introduction of *standard credit evaluations*, in which failure to achieve stated employment targets results in the borrower losing access to any additional subsidised credit. The second monitoring system entails *reductions in loan guarantees for lenders* of government subsidised credit. In other words lenders to firms that fail to meet employment targets will have to forfeit a share of their loan guarantee at stipulated points as the loan moves toward maturity. Thirdly, Pollin et al (2006) advocate the *use of escrow accounts* as a way of only releasing funds once employment targets have been met by the borrower. If the borrower fails to reach the employment target, then the escrow funds revert to the government. Since both the borrower and lender would lose money through the failure to meet the employment target, that would create an incentive on both sides to meet the targets.

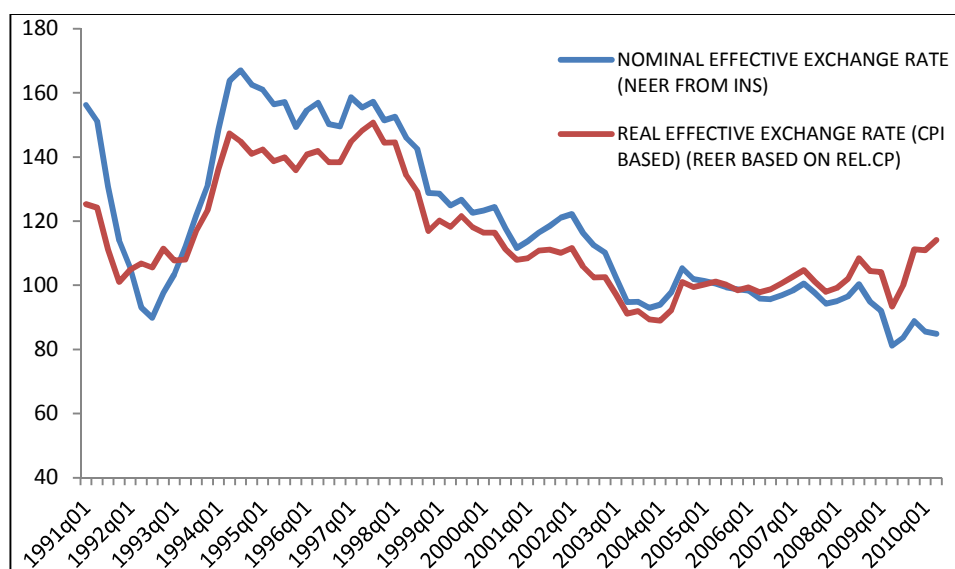
Pollin et al (2006) also suggest an alternative **employment-focused monetary policy**. Rather than targeting inflation directly or indirectly, the central bank could, with help from other government institutions, identify a target employment (or unemployment) rate and then allow monetary policy instruments (as well as fiscal and exchange rate policies) to adjust to meet this employment target.

In order to implement such an alternative monetary policy in Uganda some key conditions would need to be met. In the first instance, **more reliable data** on the employment situation are required (Sender and von Uexkull 2009). Furthermore, closer monitoring of the employment effects of macroeconomic policy decisions in general is needed. From interviews with government officials across a number of ministries and departments it was evident that the monitoring of employment and labour outcomes from particular policy choices is not a priority in Uganda. As a first step, this situation needs to be rectified. This will necessitate close collaboration between the BoU, the Minister of Labour, Gender and Social Development and the Uganda Bureau of Statistics (UBOS).

6.5 Exchange rate policy

The National Resistance Movement and the current government under President Museveni inherited a significantly overvalued exchange rate and a temporary dual exchange rate system in the early 1980s. As part of the 1987 IMF programme, the Ugandan shilling was significantly devalued and the gap between the official and parallel rate reduced (Bigsten and Mugerwa-Kayizzi 1999). The government's main objective became the need to graduate to IMF Article VIII status regarding the prohibition of restrictions on current account transactions. As a result, in 1990, the authorities legalised the buying and selling of foreign currencies in foreign-exchange bureaux at a market-determined rate. This caused the premium between the bureaux (retail) market and the official exchange rate based on the inter-bank (wholesale) market to diminish significantly. The final abolition of auction and surrender requirements took place in 1993. This was replaced by a unified foreign exchange system and a commitment to a flexible exchange rate, which has been preserved (Kasekende 2001).

Figure 21. The Nominal and Real Effective Exchange Rate in Uganda (2005=100)*



* An increase indicates an appreciation of the currency.

Source: International Financial Statistics, IMF

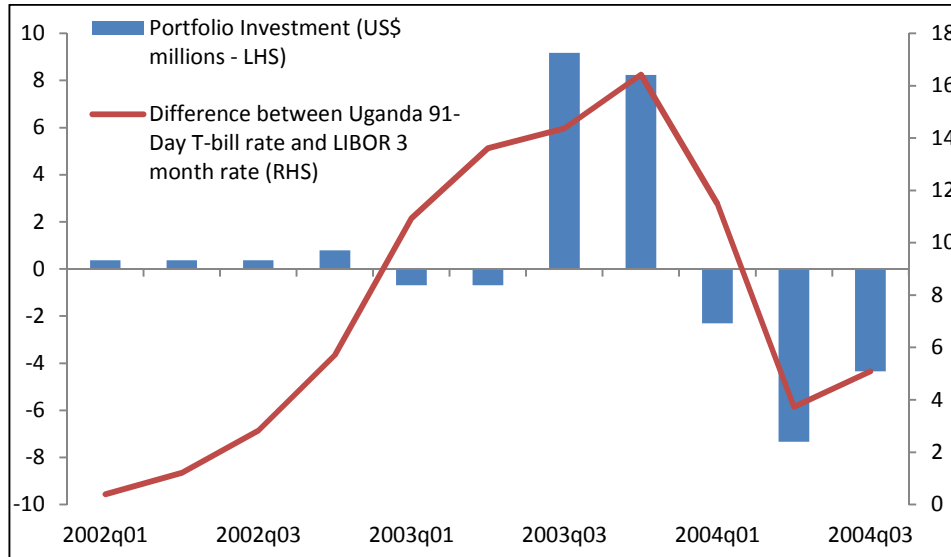
While the exchange rate depreciated significantly over the 1980s, figure 24 illustrates how, during 1993, it appreciated steeply. This was partially linked to the abolition of the foreign exchange auction and the freer movement of foreign exchange this permitted. A rise in coffee prices also contributed to the appreciation forcing the authorities to step in to prevent any further upward movement of the exchange rate in late 1993.

Since the mid-1990s the Ugandan Shilling has however been steadily depreciating against a basket of currencies in both nominal and real terms. Figure 21 shows how this depreciation continued until 2003. The movement of the Ugandan Shilling at this time is partly a reflection of movements in the terms of trade, and particularly declining trends in Robusta coffee prices at this time (International Monetary Fund 2003; Stavlot, Nannyonjob et al. 2006).

The appreciation of the Ugandan Shilling in 2003 has largely been attributed to the fall in the US\$ over this period (Kihangire and Abuka 2005). However, the sudden jump in portfolio flows at this time may also have contributed to the appreciation. Figure 22

indicates how portfolio investment rose due to the widening of the interest rate differential between Uganda and the rest of the world at this time. This sudden inflow of private capital in turn led to an exchange rate appreciation.

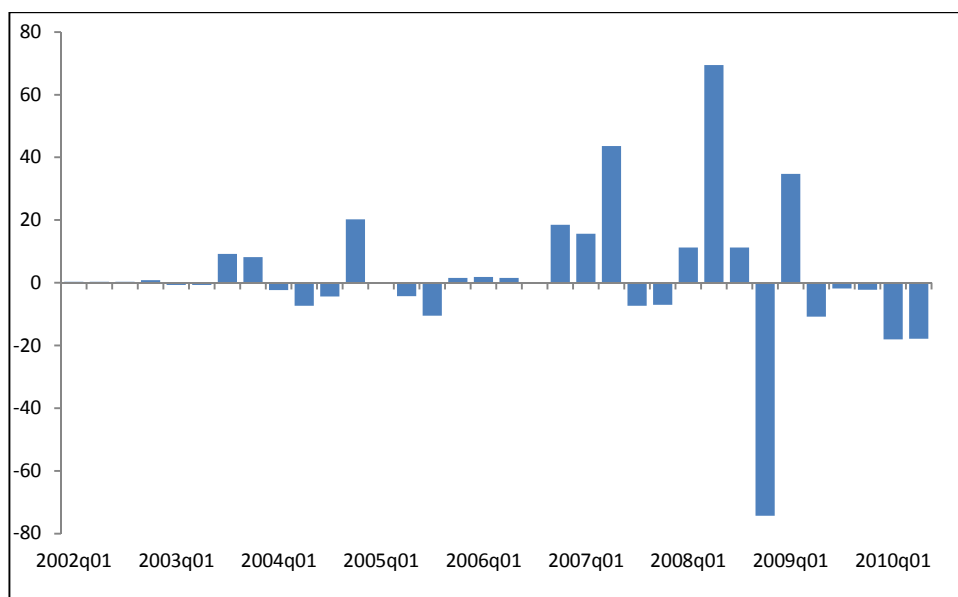
Figure 22. Portfolio Flows and Interest Rate Differentials in Uganda (2002-2004)



Source: International Financial Statistics, IMF

After the appreciation in 2003-2004, the Ugandan Shilling remained relatively stable until the on-set of the global financial crisis of 2008-2009. Once again the role of “hot money” in the form of short-term portfolio flows needs to be analysed. Figure 23 tracks portfolio flows since 2002. Portfolio flows expanded significantly over the course of the 2000s, but have been extremely *volatile* in nature. In 2007/08 Q4, Uganda saw its largest portfolio inflow, amounting to US\$ 69 million. This was soon followed in 2008/09 Q2 (i.e. the onset of the financial crisis) by Uganda’s largest portfolio outflow of US\$ 74 million.

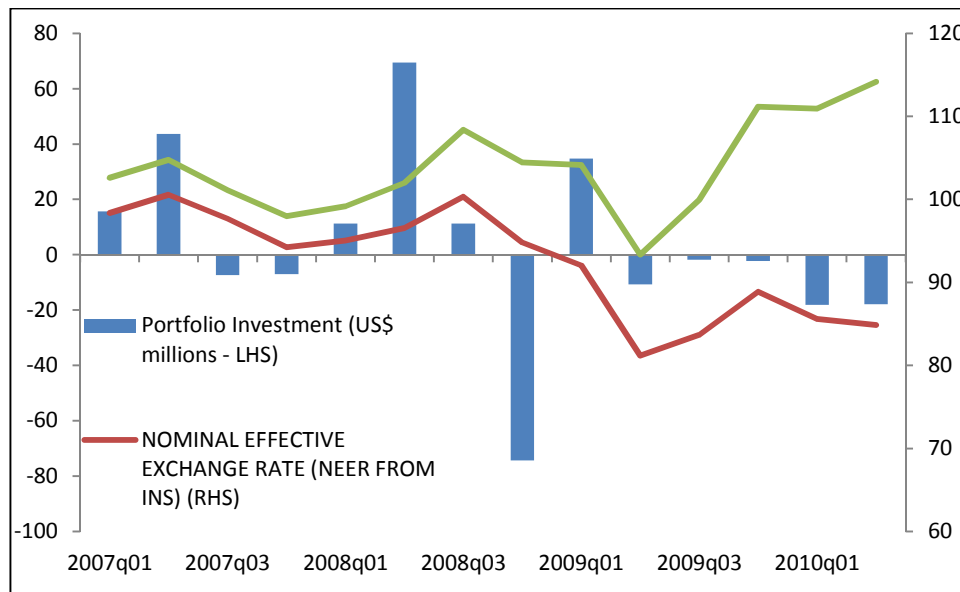
Figure 23 Portfolio Flows in US\$ millions (2002-2010)



Source: International Financial Statistics, IMF

Figure 24 displays the close link between these large portfolio flows and the movement of the real and nominal exchange rates over this period. Following large inflows of portfolio flows such as in Q2 2007 and Q2 2008, the exchange rate appreciated in nominal and real terms. The opposite has been the case following large outflows, such as in Q4 2008. Ltaifa et al. (2009) account for the real appreciation since mid-2009 in terms of other factors, including the rapid depreciation of the US\$. Anecdotal remarks from officials in Uganda, however, suggest that the volatility in the exchange rate over recent months is mainly linked to short-term speculative currency trading.

Figure 24. Portfolio Flows and the Nominal and Real Effective Exchange Rate in Uganda (2007-2010)



Source: International Financial Statistics, IMF

While remaining committed to a flexible exchange rate, the BOU intervenes sporadically in the foreign exchange market to try and limit excess volatility (International Monetary Fund 2010). The extent to which it can intervene to stabilise its exchange rate, when seeking to support the shilling, is, however, limited by the floors on international reserves determined by its IMF programmatic requirements. Kasekende (2001, p. 116) observed that: “(t)ypically, the floor on NIR [net international reserves] at the Central Bank is set at a level which precludes any substantial use of foreign reserves to support the exchange rate, even for countries that have very healthy levels of foreign reserves. This is intended to protect reserves from being depleted through intervention. It would be prudent if the NIR target in IMF programmes were designed more flexibly, to allow Central Banks increased scope for intervention to support the exchange rate”. Moreover, attempts to stem a depreciation of the currency are often accompanied by increases in the interest rates in the interbank market and on repo instruments (with the proclaimed aim of stemming the inflationary pressures that would emerge from the increases in the price of imported goods that result from the depreciation of the domestic currency).⁵⁰

⁵⁰ See the declaration by the Governor of the BOU on 19th of January 2011: “We believe that the current level of the ... exchange rate is undervalued. Moreover, further depreciation will be counterproductive for macroeconomic management, especially because of the impact this will have on the prices of imported goods and hence on consumer price inflation. Consequently, the Bank of Uganda intends to adopt a more aggressive stance to support the exchange rate. We sold

Also, when intervening in the Inter-Bank Foreign Exchange Market (IFEM) through the purchase of foreign currency in an effort to lean against an appreciation, there could be additional benefits from foreign exchange interventions by the BOU, if the BOU would refrain from its common practice of using sterilisation policies to mop up the liquidity infused in the economy as a result of such interventions. As it stands, however, in Uganda, the monetary policy target of an inflation rate of 5 per cent dominates other policies, including exchange rate management.

6.6 Policy options for improved exchange rate management

Following Gottschalk (2008) the primary objective of the exchange rate should be to support both export and import-competing industries. In this respect a slightly undervalued and stable exchange rate is crucial. The preference for fully flexible exchange rate regimes, promoted by the Bretton Woods Institutions, should be replaced with a more managed approach to the exchange rate, allowing countries to adapt to volatility and to avoid the consequences of large appreciations or depreciations.

In the longer-term the pursuance of a **competitive (slightly undervalued) exchange rate** is to be supported. This will help support both domestic export-oriented industries as well as import-competing sectors, where employment-output ratios tend to be higher (Gottschalk 2008).

Given that Uganda's priorities, as set out in the National Development Plan, relate to infrastructure and productive employment-intensive sectors, it is evident that demand for imported capital goods will rise. A devalued exchange rate will therefore need to be complemented by policies that ensure access to important capital and intermediate goods at a reduced rate for domestic private and public investors. This may require policy intervention beyond the exchange rate through subsidies for essential capital and intermediate input goods and the taxation of non-productive luxury imports (Saad-Filho 2007).

Given that Uganda currently has a de jure free floating exchange rate regime, maintaining a stable slightly devalued exchange rate over time is not possible. The adoption of an intermediate exchange rate regime, instead of the current free floating system, should therefore be explored in the Ugandan context. Since intermediate exchange rate regimes are not committed to maintaining a fixed or fully flexible rate, there is room for policy intervention for fostering economic growth and employment expansion, especially when governments also pursue capital-management initiatives, discussed below (Epstein, Grabel et al. 2003).

One option for the Ugandan authorities would be to adopt a BBC⁵¹ regime, in which the Ugandan Shilling is permitted to move within a band against a basket of currencies. Under a BBC regime both the central reference rate and the width of the band can be adjusted in line with changing macroeconomic conditions (Kaltenbrunner and Nissanke, 2009 and Williamson 2007). The adoption of a BBC regime would help Uganda deal with unwanted exchange rate volatility and at the same time provide some flexibility for domestic monetary policy. One reason the adoption of a managed exchange rate regime has been less attractive for many developing countries to date is due to the need to stockpile large international reserves, given the open capital account of most developing countries and the perceived exposure to large speculative attacks on the exchange rate. However, Kaltenbrunner and Nissanke (2009) show that, in fact, an intermediate regime

dollars yesterday to the interbank market...We are complementing this by raising interest rates in the interbank market and on repo instruments”.

⁵¹ BBC stands for basket, band and crawl

could have stabilising properties by pushing speculative “noise” traders, who are only trading for short-term gains, out of the market. Furthermore, below we discuss the potential for countries such as Uganda to introduce some forms of capital controls alongside the adoption of an intermediate exchange rate regime. Increased exchange rate volatility since the opening of the capital account has created a more uncertain environment for business and industry in Uganda. There is therefore an urgent need for the Ugandan authorities to find ways of managing these large and sudden movements in the exchange rate, linked to speculative and short-term capital flows. The current policy of occasional intervention by the BOU to help smooth the exchange rate has been too tentative and has been exploited by short-term market actors speculating on the exchange rate. Greater credibility and commitment to exchange rate interventions could help to stabilise exchange rate dynamics through altering the expectations and behaviour of participants in the exchange rate market. (Kaltenbrunner and Nissanke 2009). We return to other measures for dealing with capital flow volatility in the next section.

Kasekende (2001, p. 119) also suggested the following policy option to deal with the problem of exchange rate volatility: “The government should consider restricting foreign-exchange deposits to savings and fixed deposit accounts, and depositors should pay a tax for the withdrawal of foreign exchange effected (sic) before the maturity of savings/fixed deposits. Such measures would reduce the volatility of these deposits and thus stabilise the exchange rate.” Interviews in Kampala indicated that other measures, such as a “minimum-stay-tax” could be introduced to reduce the fickleness of short-term flows and reduce the exchange rate volatility these cause.

6.7 Capital account policy

Prior to the liberalisation of the capital account in 1997, Uganda enforced numerous controls over capital account transactions. An example was the outlawing of holding foreign-currency denominated bank accounts both at home and abroad by residents and non-residents. As part of the liberalisation process, these and numerous other restrictions were lifted (Kasekende 2001; Atingi-Ego 2005).

Table 3: Capital Controls in Selected Sub-Saharan African Countries

	Ghana	Kenya	Nigeria	Rwanda	Tanzania	Uganda	Zambia
Controls on:							
<i>Capital market securities</i>	●	●	●	●	●		
<i>Money market instruments</i>	●	●	●	●	●		
<i>Collective investment securities</i>	●	●		●	●		
<i>Derivatives and other instruments</i>	●	●			●		
<i>Commercial credits</i>			●	●	●		
<i>Financial credits</i>				●	●		
<i>Guarantees, sureties, and other financial backup facilities</i>				●	●		
<i>Direct investment</i>	●			●	●		
<i>Liquidation of direct investment</i>			●		●		
<i>Real estate transactions</i>		●			●	●	
<i>Personal capital movements</i>			●	●	●		
Provisions specific to:							
<i>Commercial banks and other credit institutions</i>	●	●	●	●	●	●	●
<i>Institutional investors</i>	●	●	—	▲	●	●	—
Key:							
● Indicates that the specified practice is a feature of the exchange system							
— Indicates that data were not available at time of publication							
▲ Indicates that the specified practice is not regulated							

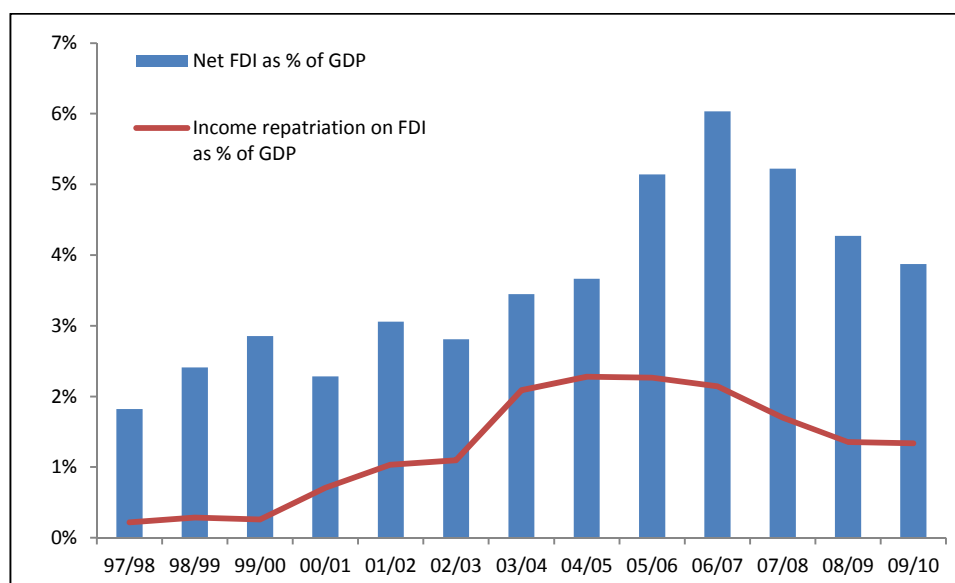
Source: Ltaifa, Kaendera et al. (2009)

Table 3 displays Uganda’s relative capital account openness when compared to other sub-Saharan African countries. Except for transactions relating to the real estate sector, Uganda has eliminated all capital account controls. The rationale for opening the capital account is that this will increase efficiency and policy discipline. The argument, as reproduced by Epstein and Grabel (2007 p. 6), implies that: “(a)n increase in capital inflows will inaugurate a virtuous cycle by increasing a nation’s capital stock, productivity, investment, economic growth and employment”.

At first glance, and as illustrated in Section 3 of this report, capital account liberalisation has not achieved the desired outcome of increasing resources for productive and employment-intensive investment. Previous discussion of monetary issues has also drawn attention to the prohibitively high interest rate spreads and lending rates in Uganda. Clearly, capital account liberalisation has not facilitated the lowering of these spreads. The section on monetary issues, further, highlighted weaknesses in the extension of credit to the private sector in general and to productive, employment-intensive manufacturing and agricultural sectors in particular.

A number of commentators (UNCTAD 2000; Basu and Srinivasan 2002; World Bank 2007; Selassie 2008) have pointed towards a sharp rise in foreign direct investment (FDI) in Uganda that can be linked to domestic and external liberalisation efforts. Figure 25 shows this increase in FDI as a percentage of GDP until 2006/07.

Figure 25. FDI and Direct Investment Income Outflows (1997/98-2009/10)



Source: Bank of Uganda, Balance of Payment Statistics

However, a number of caveats need to be raised regarding the behaviour of FDI in Uganda. Firstly, a closer consideration of outflows of direct investment income displays a somewhat different picture. Figure 25 also displays income repatriation on FDI, apart from FDI flows as a share of GDP. At its height, in 2004/05 over half of FDI was flowing back out of Uganda in the form of profit and income repatriation under the current account.

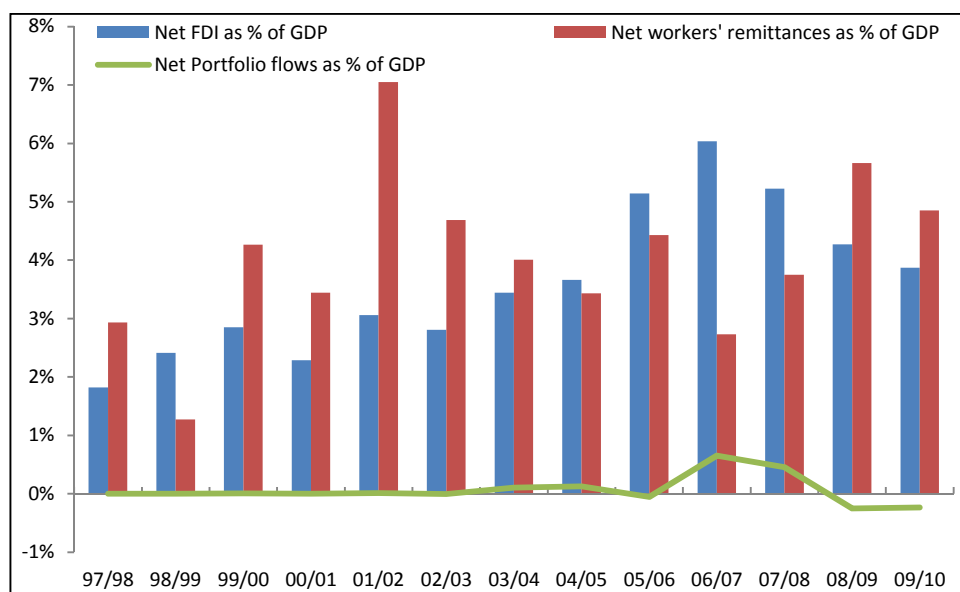
Secondly, the contribution of increases in FDI to new and productive capital formation and employment creation can be questioned on the grounds that it has been closely linked to Uganda’s privatisation program (Obwona and Egesa 2006 and te Velde 2004). In other words a small percentage of FDI into Uganda has been greenfield

investment. Kibikyo (2008) adds that the privatisation programme and the FDI this attracted have been far from positive from the perspective of workers.

Thirdly, FDI was clearly not immune to the impacts of the global economic crisis. Instead FDI fell by a third (in GDP terms) between 2006/07 and 2009/10.

With these caveats in mind it is imperative to look beyond FDI to other financial flows in Uganda. Figure 26 illustrates how workers' remittances have rivalled FDI flows in the late 1990s and early 2000s and again in the last two years. Compared to FDI and remittance flows, portfolio flows still represent a small element of Uganda's financial flows. However, their relatively small size does not prevent them from having a significant impact on macroeconomic variables, such as the exchange rate in Uganda (see previous discussion).

Figure 26. FDI, Portfolio and Remittance Flows in Uganda (1997/98- 2009/10)



Source: Bank of Uganda, Balance of Payment Statistics

Previous discussions under monetary and exchange rate issues have demonstrated some of the detrimental impacts of uncertain financial flows on the exchange rate and on longer-term investment and employment goals. The decision by Ugandan authorities to liberalise the capital account has increased the uncertainty of these flows and exacerbated their impact on other macroeconomic variables.

Like other countries that have undergone capital account liberalisation, Uganda has not seen the purported benefits from this and has instead witnessed increased volatility in financial flows with detrimental repercussions for both exchange rate stability and longer-term productive investment (Epstein and Grabel 2007; Epstein 2009).

6.8 Policy options for managing the capital account in Uganda

Epstein and Grabel (2007) argue for capital account management that generates stability and reduces vulnerabilities to pro-cyclical and potentially crisis-inducing financial flows. Capital account policies should support financial policies in creating an environment conducive to the mobilisation of private and public savings. In addition policies should support employment-generating productive investments by ensuring basic financial and banking services are available to all.

In light of the above discussion it is helpful to develop some policy options that may help to rectify some of the current concerns with FDI and portfolio flows in Uganda.⁵²

Uganda has benefited to some extent from increased FDI flows over the last 15 years. However, a larger concern has been the repatriation of profits and incomes from FDI. Other countries in sub-Saharan Africa have successfully managed this problem by maintaining some controls on their capital account to **manage FDI** as much as possible. For example, Ghana, Nigeria, Rwanda and Tanzania all maintain some restrictions on the repatriation of capital proceeds (Ltaifa, Kaendera et al. 2009). While it is difficult to judge the effectiveness of such measures on overall FDI flows to specific countries, Uganda and its East African Community neighbours may want to consider policies on FDI repatriation at a regional level. A regional policy may avoid some of the concerns over the loss of FDI to neighbouring countries that do not have such restrictions in place.

Ugandan authorities may also want to consider monitoring the impact of FDI on employment outcomes explicitly. Currently efforts to gauge the impact of FDI on employment generation and wages are limited and need further improvement so that policymakers can develop a clear vision of how FDI can contribute to the country's overall macroeconomic and employment aims.

The debate surrounding the use of capital controls to **manage sudden portfolio flows** has recently been revived, with IMF researchers cautiously welcoming the use of such controls. "A key conclusion is that, if the economy is operating near potential, if the level of reserves is adequate, if the exchange rate is not undervalued, and if the flows are likely to be transitory, then use of capital controls—in addition to both prudential and macroeconomic policy—is justified as part of the policy toolkit to manage inflows" (Ostry et al. 2010, p. 5).

Within sub-Saharan Africa, a number of countries have preserved capital controls on certain transactions, such as the limitations of foreign purchases of certain financial instruments or taxes on selected inflows (see table 3 above). Ltaifa et al (2009) provide a detailed summary of the types of controls across seven sub-Saharan African economies. In the context of the East African Community and the volatile nature of portfolio flows in Uganda, authorities may want to explore and evaluate the effectiveness of these policies in neighbouring countries. The 2010 Trade and Development Report (UNCTAD 2010, p. 160) reminds us that: "(t)o this end, capital controls not only help better management of exchange rates and monetary policy, they also prevent excessive inflows of capital that erode policy space of the kind needed to improve labour market conditions."

Capital controls can be imposed through price-based measures (taxes) or through restrictions on the purchase of specific assets. They can include restrictions on the acquisition of stakes in banks (Ghana), restrictions on the purchase of government securities (Kenya), restrictions on investments in stock markets (Tanzania), restrictions on the purchase of money market and debt instruments (Ghana and Nigeria), and restrictions on the repatriation of foreign direct investment proceeds (Ghana, Nigeria, Rwanda and Tanzania) (see Ltaifa et al. 2009). In this context, Ltaifa et al. (2009, p. 11) observe that: "countries with the least restrictions registered the largest exchange rate

⁵² During interview with a BOU official the view was expressed that Uganda had probably liberalised its capital account too quickly in the context of a financial sector that remains so underdeveloped. This was presented as being one of the drawbacks of accepting IMF conditionalities. The interviewee added that the BOU is investigating ways in which it could manage short-term flows (such as, for instance, through a "minimum stay" tax). The interviewee was however adamant that there was no intention of imposing capital controls.

fluctuations in the wake of the global crisis". Such an observation can only serve to strengthen the argument for better management of the capital account.

7. Beyond macroeconomic policies: structural and labour market policies for Uganda

This report has been concerned with analysing Uganda's economic challenges, focusing on macroeconomic variables and lessons for an alternative macroeconomic framework that can help to foster an expansion in productive employment and decent work for all. In attempting to achieve these objectives it is clear that constructive changes to macroeconomic policy *alone* will not be sufficient. Instead important complimentary structural and institutional policies are needed. Although beyond the scope of this paper, this section is devoted to outlining three important areas specific to the Ugandan context that require urgent attention by policy makers in order for the full and productive employment agenda to be met.

The three areas are a) policies that address the structural causes of the Ugandan employment situation and foster structural transformation of the economy; b) policies that strengthen labour market institutions in the country; and c) policies that deal with the demographic challenge and the current mismatch of skills versus job opportunities in Uganda.

7.1 Fostering structural transformation of the Uganda economy

It has been highlighted throughout this report that a sole focus on changing the policies at the macroeconomic level is insufficient to foster the necessary structural transformation of the Ugandan economy and the attendant "productive employment" agenda to take effect.

If an alternative macroeconomic agenda, as set out across the sections above, would imply the elevation of public investment (or fiscal policy) and the subordination of monetary policy, exchange rate policy and capital account management to this reprioritisation, then this would only acquire meaning or become effective if this particular public investment agenda is driven by, and anchored in, clear and focused strategies for the agricultural and industrial sectors. There is need for strategic interventions by the state that "catalyse structural change and stimulate economic restructuring towards more dynamic, higher value-added activities" (UNCTAD 2009, p. 143). Stated differently, in low-income countries, the state must lead in economic transformation, as the private sector is often too weak to carry out this role.

In Uganda, there has been fast growth of the private sector between 2001 and 2007, but most of this growth was concentrated in small firms with low value addition. Firms with high value added per employee did not increase as quickly. The National Development Plan conceded that this rapid growth in enterprises, which are focused on low-value services, is "unlikely to be a platform for significantly transforming the economy" (Republic of Uganda 2010, April version, p. 24).

Assessing the scope for the full and productive employment and decent work for all agenda to take effect therefore necessitates a close look at the nature of the sectoral strategies proposed and implemented by the Ugandan government.

In relation to the agricultural sector, UNCTAD (2009, Chapter 3) advocates the need for an integrated agricultural policy that jointly tackles deficiencies in infrastructure, access to seeds and fertiliser, and the technical upgrading of production methods. In the Ugandan context this requires increased government spending allocations to the agricultural sector, strategically fostering the exportation of processed

rather than unprocessed agricultural commodities and helping to solve rural infrastructure weaknesses.⁵³

The Parliamentary Committee on the National Development Plan further argues that the latter did not give sufficient attention to the issue of food security nor to the President's aspiration of processing food items that are not consumed as fresh food (locally or regionally) (Parliament of Uganda 2010, p. 16): "The committee observes that specific interventions as stated among the flagship projects which are aimed at providing an impulse to unlocking the identified binding constraints do not cater for the critical need of food security. In this regard, the Committee recommends that silos and industries that will process and preserve food should be among the flagship projects [of the NDP] and have the established in all districts of Uganda. This will also facilitate the President's aspiration of processing any food item that is not eaten fresh, at the sub-country level".

In the context of the industrial sector, a cursory glance at recent policy documents, including the National Industrial Policy (Republic of Uganda 2008), reveals a persistent preoccupation in Uganda with a *facilitating* role for the government in creating an "enabling" environment for the private sector (improving the "investment climate for private sector development"). The idea is that an enabling macroeconomic and business environment will elicit the private sector's transformative and dynamic role in the economy, which will allow for optimal resource allocations (as well as sustained productivity increases?).

Indeed, most recently, in November 2010, a new investment reform programme was launched by the Ugandan government in collaboration with the World Bank Group, which seeks "to improve and reform [Uganda's] business and investment regulations to stimulate broad economic growth, especially the growth of smaller business". The programme will focus on reducing regulatory costs and risks associated with business licenses and on simplifying and reducing taxes for small and medium enterprises. The presumption is that if regulatory barriers to the growth of small and medium enterprises are removed, growth will flourish.

It has been argued above, however, that the Ugandan economy's main problem is its lack of structural transformation rather than the growth of small or medium enterprises, with the latter unlikely agents to bring about such transformation by themselves (even if the "correct" price and regulatory incentives prevail). The *2009 Least Developed Countries Report* (UNCTAD 2009, p. 143) further reminds us that "it is a necessary condition for states to engage in developmental industrial policy, defined as any strategic intervention by the state that catalyses structural change and stimulates economic restructuring towards more dynamic, higher value added activities". Industrial policy emerges as "a device to promote the structural transformation of the economy by promoting investment in areas that are deemed to generate the greatest dynamic benefits and maximising the impact of these investments ... industrial policy is supposed to provide vision and direction, guiding investment towards specific sectors and technologies and addressing potential bottlenecks and investment coordination problems" (Warren-Rodriguez 2010, p. 268). Such a stance draws on the well-documented experience of the East Asian economies, where interventionist industrial

⁵³ See Joughin and Kjaer (2010) for an assessment of agricultural policy in Uganda. At the risk of stating the obvious, it is worth reminding that any agricultural policy needs to be anchored in a thorough and explicit investigation into the nature of the constraints operating on agricultural productivity (including the nature of rural differentiation and its implications), rather than being inspired by popular policy prescriptions such as for instance the celebration of the "small farmer". See Oya (2010) for a general overview.

policies were combined with managed trade, close finance-industry links and social policies that raised the skill level of the labour force.

In this context, the historic performance of the Ugandan industrial sector is worth recalling (Ministry of Tourism, Trade and Industry and UNIDO 2007, p. 4):

Uganda was one of a few African countries with a thriving industrial sector prior to independence. There were small, medium and large-scale industries. Uganda Development Corporation (UDC) established in 1952; was charged with responsibility of promoting establishment of industries, including joint ventures, of negotiating finance and attracting direct foreign investment, as well as promoting establishment of industrial research institutions and related support services. Uganda's manufacturing sector was developed mainly through import substitution with a focus on production of consumer goods. Industries relied heavily on imported factor inputs. They were protected and sometimes subsidised. Approved policy measures aimed specifically at foreign investment. Established industries included those producing textiles, soaps, vegetable oils, cigarettes, beer, soft drinks and other beverages, sugar, cement, footwear, etc...

Such an assessment was echoed in the *2009 Least Developed Countries Report* (UNCTAD 2009, p. 171), implying particular policy lessons:

In terms of the performance of the manufacturing sector, Uganda's experience with import-substituting industrialisation was unsurpassed. Indeed, from 1963 to 1970, the manufacturing sector grew at 8.3 per cent per annum. In the 1970s and 1980s, the country experienced a long period of political instability and civil unrest. In the 1980s and 1990s, it followed neoliberal proscriptions that denied any role for industrial policy. As in other African countries, such structural adjustment policies led to very disappointing results. Consequently, the State withdrew, but the private sector did not step in to fill the void.

Since the early 1990s, Uganda's development strategy has been devised in terms of strong reliance on the private sector, as the government's role became understood predominantly in terms of providing an "enabling environment", with a particular focus on small and medium enterprises, rather than through the provision of strategic leadership in industrial development.⁵⁴ This strategy has not borne fruit in terms of fostering structural diversification and upgrading and is in need of serious rethinking.

Industrial policy cannot be confined to a policy stance that is concerned with improving the investment climate in general terms. Instead, it needs to be driven by targeted interventions aimed at promoting the development of particular subsectors of the Ugandan economy. These could include agro-processing (of for instance food crops, cotton and coffee) as well as various subsectors linked, e.g. , to the fast-growing hospitality sector, including processed food, cleaning supplies, uniforms, furniture, textiles, soaps, cement, etc.⁵⁵

⁵⁴ The National Industrial Policy (Republic of Uganda 2008, p. 10) highlights that: "In the 1990s liberal economic reforms were introduced to create an enabling environment for the private sector. Such reforms included the effective implementation of the Investment Code of 1991, the gradual privatisation of public enterprises, the reduction of import tariffs, the elimination of licensing requirements, lifting of import bans, the elimination of export taxes, the harmonisation of tariffs within the East African Community, and trade liberalisation in general".

⁵⁵ Cramer (1999) summarises the potential advantages of focusing on processing of primary commodities as follows: "Two chief motivations for promoting the processing of primary commodities in low-income countries are: that *a priori* it seems reasonable to try to capture higher value added from goods already exported but at a lower rung on the value chain; and that empirical evidence suggests that there are price and non price advantages to processed commodity exports over unprocessed goods. The higher value added to production by processing or semi-

Further, focusing on primary commodity processing should not be to the exclusion of other sectors that have the potential for long-term employment creation and structural transformation of the Uganda economy. UNIDO (2007) concurs with the need for an industrial policy that develops the links between the agricultural and industrial sectors in Uganda, but, also highlights the possibility of strategically fostering other sectors, such as engineering and chemical industries.

In this vein, the National Industrial Policy (Republic of Uganda 2008, p. 7) proposes to focus on the following sectors: natural domestic resource-based industries such as petroleum, cement, and fertiliser; competitive industries that use local raw materials; agro-processing (focusing on food processing, leather and leather products, textiles and garments, sugar, dairy products, and value addition in niche exports); knowledge-based industries such as: ICT, call centres and pharmaceuticals that exploit knowledge in science, technology and innovation; engineering for capital goods, agricultural implements, construction materials.

A closer look at the way in which the Government would seek to operationalize this focus, however, reveals the persistence of an approach heavily biased towards a “business friendly environment for private sector-led industrialisation” (Republic of Uganda 2008, p. 7). The 2008 National Industrial Policy explicitly emphasises “the need to minimize resistance to market signals in the course of resource allocation”, in a persistent commitment to an underlying argument of static allocative efficiency rather than that the importance of dynamic considerations involving scale and productivity are taken into account.⁵⁶ Further, the Ugandan government remains staunchly committed to a liberalised trade environment, with strong implications for the scope (and effectiveness) of an industrial policy strategy. Finally, as long as the recent attempts to revive the Uganda Development Bank (UDB) and the Ugandan Development Corporation (UDC) – despite reprobation from the IFIS (see above) – are not integrated into a broader strategic approach to both the industrial and agricultural sectors that puts dynamic considerations at its centre, these initiatives may be doomed to remain of limited significance.

7.2 Strengthening labour market institutions in Uganda

Beyond both macroeconomic and sector-specific structural policies, the Ugandan authorities need to pay close attention to the current state of labour market institutions in Uganda, if the “decent work for all” agenda is to have a chance of real success in the country. This includes the nature of the labour laws and how these are enacted; the state of trade union recognition; the difficulties facing unions in organising casual workers; and the status of negotiations regarding the minimum wage – which has still not been adopted in Uganda (see Barya 2010).

processing primary commodities is expected to bring forth a range of benefits. Employment creation effects are expected, directly and indirectly. The scope for domestic linkages may be expanded: this can work directly through backward linkages feeding into a provocation to greater raw material production and improved investments in infrastructure, or indirectly through linkage stimuli to suppliers of goods and services required by processing factories, as well as through employment and fiscal linkages.”

⁵⁶ The document adds that “Uganda rates relatively highly on several market efficiency indicators in the Global Competitiveness Report (especially on labour market flexibility, foreign investment freedom and extent of bureaucratic ‘red tape’), though there are also areas of weakness in the form of regulatory standards, trade barriers, time to start a new business ...” Clearly, the benchmark remains a world of perfect working markets in which price signals allocate scarce resources efficiently, without any regard for the adequacy of such a model as a description of the Ugandan realities or for the dynamic considerations bearing on industrialisation processes and strategies.

Sender and von Uexkull (2009, pp. 60- 66) provide a summary evaluation regarding these issues. Their overall assessment reveals a status-quo in which labour market institutions are weak and offer limited protection to vulnerable workers. This picture is supported by interviews with trade union officials completed for this Report. Trade union representatives identified concerns over the lack of union recognition in Uganda, especially by sectors dominated by large multinational companies or with historically low trade union membership, such as the telecommunications and construction sectors, respectively. Barya (2010, p. 102) also points out how the Government of Uganda has failed to enforce the laws on trade union recognition and has failed to recognise and bargain effectively with the public sector trade unions for civil servants, health workers and teachers: “Although these sectors have registered unions, some from as far back as 1993, government has not signed a recognition agreement with any of them. Thus they cannot collectively bargain or carry out their other representative functions”.

A lack of capacity within trade union organisation to engage with the public and private sectors on substantive policy issues was also evident. While the impacts of macroeconomic and structural (or lack of) government policies were having a detrimental impact on trade union members, representatives felt they lacked the necessary capacity to engage the government on these issues. A lack of funds and knowledge within trade unions has hampered their ability to conduct their own research and to perform their advocacy role.

This situation may have been further exacerbated by the focus of international organisations, including the ILO, on specific high-profile structural challenges, including child labour and HIV/AIDS in the workplace. While these issues are of paramount importance, a training focus on these issues has, in Uganda, been at the expense of educating trade union members about economic policies, their potential impacts and possible alternatives.

Further, as in many low-income countries, Uganda has a large informal and non-unionised workforce.⁵⁷ Finding ways of extending trade union membership and ensuring union recognition across traditionally poorly represented sectors must therefore be a priority. Where unions are active it is crucial that government ministries engage and consult these unions on major policy shifts that impact the labour market, in the same way as representatives of the private sector are currently consulted. In many cases a pre-requisite for such consultation will be capacity development within these institutions. Both national and international agencies can assist in this respect.

Most recently, the National Employment Policy has been approved. The trade unions now wish to see directives issued by government to ensure the implementation of the policy. They are also demanding a full-fledged Ministry of Labour rather than a Ministry of Labour, Gender and Social Development, to ensure better engagement on behalf of government with labour issues, and an effective industrial court.

7.3 Meeting Uganda’s demographic and skills mismatch challenge

In the background of the above discussion concerning macroeconomic, structural and institutional policies, Uganda’s demographic challenge looms large. Uganda has a very large and growing proportion of young people who are either un- or under-employed. With some of the highest fertility rates in the world, Uganda’s labour supply

⁵⁷ Barya (2010) highlights that the casually employed increased dramatically (and formal employment was casualised) in the wake of the extensive privatisation efforts in Uganda.

will continue to outstrip labour demand in the future. Sender and von Uexkull (2009) argue that there would be very significant pay-offs to reducing fertility levels.

Klasen and Lawson (2007) further demonstrate the circular nature of links between employment creation and fertility rates. Lack of female wage employment is one of many determinants of high fertility rates, while in turn achieving lower fertility rates would help to solve some of the persistent long-term labour supply issues. Unfortunately, in general, lowering fertility rates is a very difficult objective to achieve significant progress in over even the medium-term. Sender and von Uexkull (2009) explain in greater depth some of the reasons why the Ugandan record of lowering fertility rates has been so poor.

Further, the mismatch between the level and types of skills of Ugandan employees and those demanded by employers is a problem of which the Ugandan authorities are all too aware. It has been highlighted in the National Development Plan (Republic of Uganda 2010, p.29):

Despite the large and fast growing youthful labour force and the government's efforts to provide education and training at various levels, the country continues to experience deficits in the supply of skilled human resources. This is evident in the limited availability of skilled labour as partly shown by wide wage differentials, and the high number of vacant posts in technical areas. The lack of skilled human resources is associated with quality issues in the education system, including low school completion rates, limited capacity in the vocational and technical training institutions, and the brain drain from the country. This is exacerbated by inadequate manpower planning in key areas of the economy.

Concerns over access and availability of vocational training and appropriate skills development was reiterated during interviews for this Report with various national policymakers and donor representatives. The recently ratified National Employment Policy (Ministry of Gender, Labour and Social Development 2010), also acknowledges the severity of the problem.

The NEP (Ministry of Gender, Labour and Social Development 2010) proposes several ways in which the Ugandan authorities should foster improved vocational training and skills development. The NDP (Republic of Uganda 2010, pp. 243-246) also suggests concrete strategies for: i) increasing access to and participation in a coherent and flexible skills development system; ii) improving the quality and relevance of skills development; and iii) improving the effectiveness and efficiency in the delivery of skills development. While many of these strategies rely on input from private and non-profit organisations for their implementation, placing less pressure on direct government resources, a well-integrated skills development plan will have cost implications for the Ugandan authorities. These will need to be carefully weighed against other commitments and priorities.

8. Concluding remarks

Since embarking on the Economic Recovery Program in 1987, it could be argued that the general macroeconomic framework within which the Ugandan government operates has been strongly influenced by the notions of “good” policies traditionally promoted by the Bretton Woods Institutions. These have implied an unfortunate conservative bias in macroeconomic policy making. The role of the BWIs in affecting macro policy stances remains important today, not in the least through the Fund’s programmatic ceilings, but the generally conservative bias in Ugandan macroeconomic policy has now been further compounded by a commitment to the convergence criteria of the East African Community (see table 1 above).

From interview and extensive consultation of various documents, we did not find any substantial indication that the government’s macroeconomic stance is set to change fundamentally, beyond the reorientation of spending towards infrastructure described at length above. In general, low inflation targets continue to determine the broader macroeconomic policy possibilities, with implications for fiscal positions and exchange rate management. The direction regarding actions that could be taken to limit the excessive volatility caused by short-term cross-border flows also remains unclear (see above). Further, as far as the BWIs are concerned, clear signals are given that the current macroeconomic policy stance of the Ugandan government should not be challenged or changed.

Such a persistent conservative macroeconomic stance is unfortunate, and various alternative policies were described in Section 6 above, which, if implemented, could move the Ugandan economy beyond the straightjacket within which it is currently operating.

Much as such new policy directions at the macro level are necessary, they are in themselves, however, insufficient to foster the structural diversification necessary in the Ugandan economy for “full and productive employment and decent work all” to materialise, as discussed in section 7 above. Therefore, a sole focus on the macroeconomic policy environment, while neglecting necessary supportive structural and institutional policies is misguided. Indeed, a less restrictive macro environment is a necessary but not a sufficient condition for the “productive employment and a decent work for all” agenda to acquire meaning.

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