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Macroeconomic policy, inclusive growth and productive employment in Uganda

Elisa Van Waeyenberge
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Employment
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Market Policies
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Elisa Van Waeyenberge and Hannah Bargawi

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Foreword

Achieving inclusive growth and productive employment creation is at the top of international and national agendas in both developing and developed countries today. A careful understanding of growth patterns and the evolution of the labour market based on a wide range of labour market indicators is critical for policymakers, workers' and employers' organizations in their continued efforts to promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all, Sustainable Development Goal No. 8 of the 2030 Agenda for Sustainable Development.

This paper, authored by Elisa Van Waeyenberge and Hannah Bargawi, examines the main trends in growth, employment, poverty and inequality in Uganda over the last decade, pointing to, *inter alia*, a lack of absorption of workers into high productivity sectors, with resulting implications for conditions of employment, poverty and inequality. The authors argue that the limited structural transformation is a result insufficient expansion in productive capacities by the private sector, against the backdrop of a historically weak public investment programme and a persistently lop-sided integration in international trade circuits. The authors also argue that the macroeconomic policy agenda has restricted the scope for a fundamental transformation of the Ugandan economy necessary to support much-needed job creation and increases in the standard of living. The authors point to a need for a pro-employment macroeconomic framework in Uganda, including appropriate sectoral policies, accelerating public spending complemented by efforts to mobilise domestic revenues and a rethink of monetary policy beyond inflation-targeting.

The paper was undertaken as part of a research project on “*New forms of work and income security: global and country-specific perspectives*,” funded by the Government of the Republic of Korea. With unemployment and underemployment levels remaining stubbornly high and insufficient job growth to reduce the incidence of working poverty in many parts of the world, against a backdrop of a rapidly changing world of work driven by new technologies, rapid shifts in the geography of production and trade, demographic change and other drivers, the project was undertaken with a view to building knowledge on the linkages between these areas. The support of the Government of Republic of Korea, and the ILO's Research Department, in particular Uma Rani Amara, who coordinated the project, are gratefully acknowledged.

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1. Introduction

This Working Paper analyses government policies that have sought to foster growth and employment over the last decade in Uganda. It does so with a focus on the macroeconomy, itself the result of government policies as well as providing the context within which other government policies take effect. The current contribution follows a previous Working Paper (Van Waeyenberge and Bargawi 2010) which assesses the implications of macroeconomic policy for the creation of full employment and decent work for all in Uganda. Van Waeyenberge and Bargawi (2010) highlight how an opportunity to redefine the macroeconomic policy space in the wake of the Global Financial and Economic Crisis (GFC) failed to be captured by the Ugandan authorities, as macroeconomic policy remained driven by imperatives of stability and liberalisation. Such a policy stance entailed fiscal consolidation, high interest rates, flexible exchange rates and capital account openness, with significant implications for employment outcomes. Indeed, Van Waeyenberge and Bargawi (2010) demonstrate how insufficiencies of structural transformation and poor job prospects persisted, not in the least as reflected in the highly informalised nature of work.

In this paper, we revisit the theme of how macro-financial policies condition the scope for structural transformation and the creation of employment (and more specifically decent work) in Uganda. Since 2010, the Ugandan government has launched a series of National Development Plans, the impacts of the global economic crisis continue to be felt, and, with a fast-expanding working age population, the need for “decent jobs for all” remains urgent. We draw on a broader appraisal of the realities of productive employment in Uganda that was commissioned by the International Labour Organisation (ILO) through an Employment Diagnostic Analysis (EDA) (Bargawi and Van Waeyenberge 2018). An EDA aims “to understand the nature of the deficiency of productive employment and to identify the constraints on and opportunities for enhancing inclusive job-rich growth” (International Labour Organization 2012: 1). One of its core features is that it seeks to be comprehensive through its attempt to understand various links and relationship across the economy bearing on productive employment outcomes.

While drawing on the EDA, we focus here on one aspect of the Ugandan policy environment that was identified in the EDA as exercising a strong influence on employment outcomes. This relates to the way in which the macroeconomic policy agenda continues to exert a negative effect on the scope for the fundamental transformation of the Ugandan economy necessary to support much-needed job creation and increases in standard of living.

We offer a core set of insights. First, despite progress in relation to poverty reduction and other aspects of human development, particularly during the 1990s and early 2000s, the creation of decent jobs for the rapidly expanding working-age population of Uganda remains dramatically insufficient. There is a lack of absorption of workers into high-productivity sectors. Instead, the low-productivity agricultural and services sectors continue to provide sources of employment for existing and new workers in Uganda. Furthermore, the majority of Ugandans are employed in the informal sector and many in household enterprises that share characteristics of underemployment, poor working conditions and low wages. Second, these labour market outcomes are strongly linked to the type of economic growth witnessed in Uganda over the past two decades. The insufficient structural transformation of the Ugandan economy has held back a sustained increase in gainful employment (and hence the demand for labour). Third, the Ugandan authorities are acutely aware of the need to tackle the employment challenge and have undertaken a range of initiatives, most recently through the second National Development Plan (NDP II) (Government of Uganda 2015), which recognise the urgent need for decent jobs.

However, despite important recognition of the problem, policy initiatives have suffered from two major draw-backs. The first is that policy initiatives to address the employment challenge have been piece-meal, ad-hoc, under-funded and poorly implemented. The second is the failure to root such policies within a wider framework that places structural transformation of the Ugandan economy at its core and engages with its real (rather than projected) constraints.

Fundamentally, we argue that underlying these outcomes, there is a persistent (and long-standing) disjuncture between the ways in which the Ugandan government proposes to accelerate growth and create jobs, and the reality of how other developed and emerging economies have addressed these challenges, with little sign of this disjuncture being overcome. Specifically, across different government initiatives, a contradiction recurs between, on the one hand, the government's celebration of the private sector as the most important agent to bring about growth and structural transformation, and, on the other hand, a failure to appreciate (and cater for) the specific needs of the private sector (beyond those of the financial sector). The policies that claim to support a shift towards higher productivity activities remain charted in terms of unleashing private sector entrepreneurial activity (across micro, small and medium enterprises), with insufficient acknowledgment of the intricate role the state needs to play for the private sector to develop along such a path, including through facilitating access to credit, protection of production for local markets, local content policies, specific trade policies, imposing performance criteria on strategic private sector players, etc.

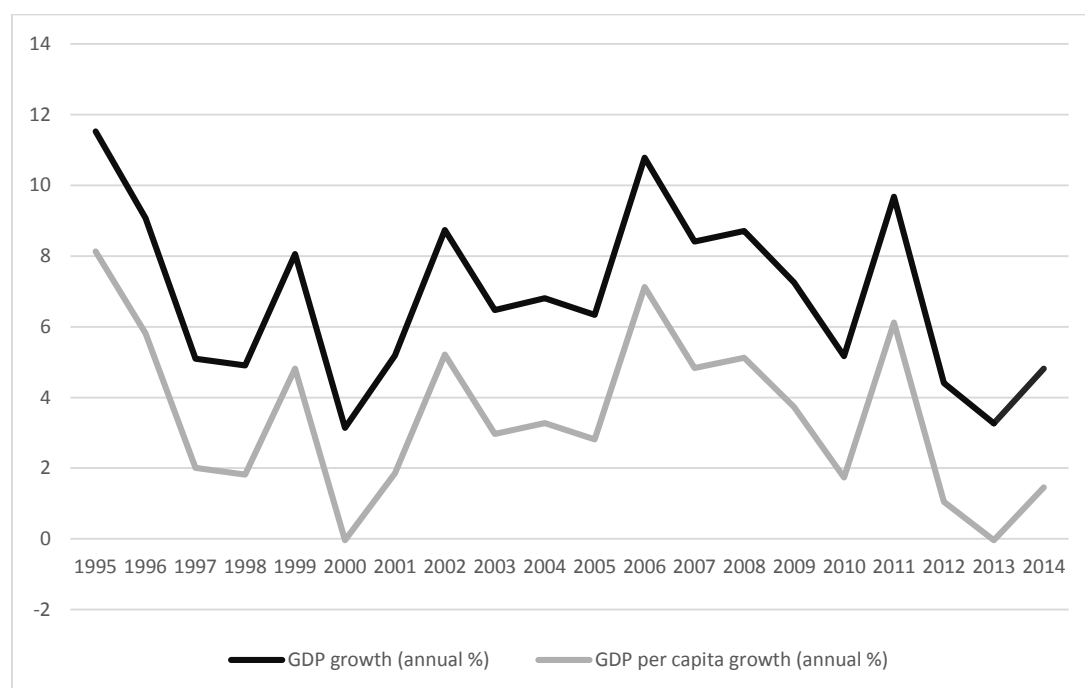
We argue that this essential shortcoming in government policy is related to a set of tensions within the Ugandan political-economy. This includes, first, the way in which short-term macro-financial priorities have dominated longer-term imperatives of growth and structural transformation. This combines, second, with (and has been exacerbated by) the ad-hoc and fragmented nature of many policy initiatives targeting specific sectors. In terms of the labour market, the effects have implied the consolidation of a "regime of informality" (Breman and van der Linden 2014) in lieu of sustained improvements in employment outcomes.

We proceed as follows. Section 2 documents main trends in growth, employment, poverty and inequality in Uganda over the last decade. This highlights the acute lack of absorption of workers in high productivity sectors with implications for conditions of employment, poverty and inequality. Section 3 unpacks the realities of structural transformation in the country. This reveals a highly fragmented and weak private sector accounting for insufficient expansion in productive capacity, against the backdrop of a historically weak public investment programme and a persistently lop-sided integration in international trade circuits. Section 4 provides an in-depth discussion of the persistent limitations imposed by restrictive macro-financial policy imperatives with negative implications for the scope to increase rapidly decent work and living standards in the Ugandan economy. Section 5 offer policy recommendations that emerge from the analysis and section 6 concludes.

2. Setting the scene: growth, employment, poverty and inequality in Uganda

While Uganda's GDP growth has been relatively strong between the mid-1990s and the mid-2000s, growth has decelerated since 2006 (with the exception of 2011). Figure 2.1 illustrates the fast deceleration of GDP growth rates from 2006 onwards. In per capita terms, growth slowed to average less than one per cent between 2012-2014. This compares to a per capita growth rate in excess of three per cent for most of the first half of the 2000s. Preliminary data for FY 2015/16 show that GDP expanded by 4.6 per cent in real terms, which is slightly lower than the five per cent growth rate recorded for 2014/15 (Bank of Uganda 2016: 36). This is below the target rate of at least seven per cent per annum recommended by the 2011 Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the so-called Istanbul Programme of Action (UNCTAD 2016: 2).

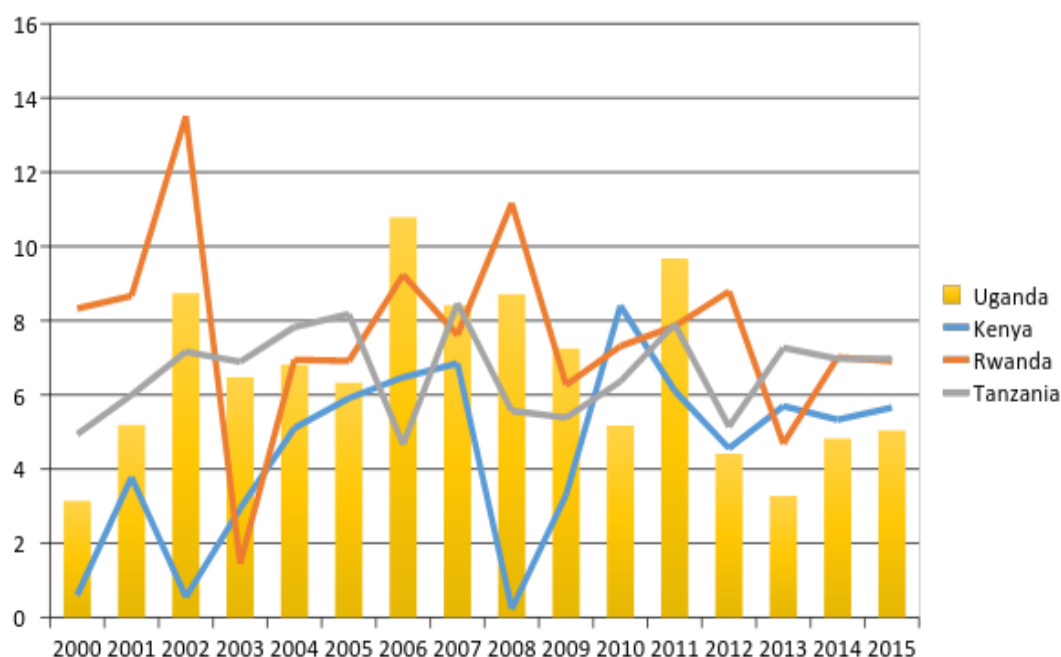
Figure 2.1. GDP annual rates of growth; per capita GDP growth, 1995-2014



Source: World Bank, World Development Indicators.

Compared to other East African Community (EAC) economies, the growth performance of Uganda has also been below par. Growth rates have been consistently below those of neighbouring East African economies since 2010, with the exception of 2011 (see Figure 2.2).

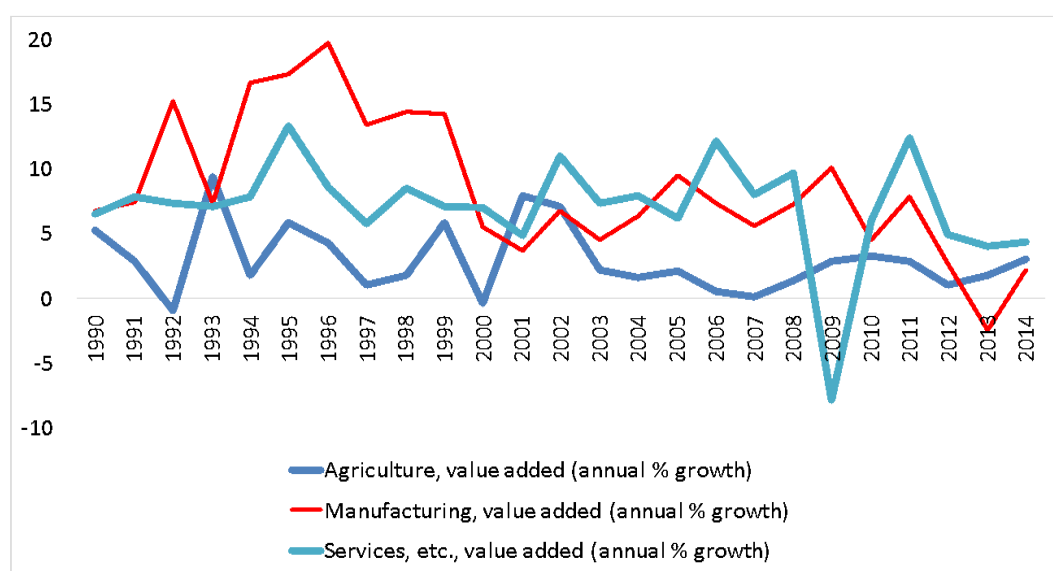
Figure 2.2. GDP growth rates, 2000-2015 (Uganda, Kenya, Rwanda, Tanzania)



Source: World Bank 2016 World Development Indicators

Overall, growth of the Ugandan economy has been driven by the service sector. Figure 2.3 shows how services grew steadily during the 1990s and early 2000s, but started to experience decelerating growth rates from 2006 onwards (again, with the exception of 2011).

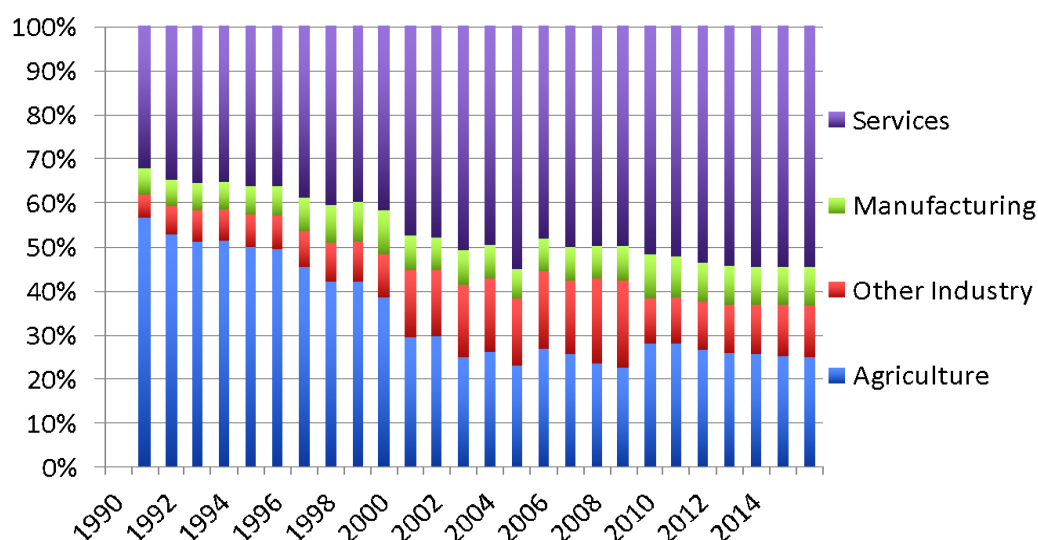
Figure 2.3. Annual % sub-sector growth rates, 1990-2014



Source: World Bank 2016 World Development Indicators

For the economy as a whole, services produce the largest share of GDP since the turn of the millennium, accounting most recently for just under 50 per cent of domestic output (see Figure 2.4). The service sector is dominated (in terms of output share) by trade (13 per cent of GDP), followed by education (5.5 per cent), health and social work (4.5 per cent), real estate (4.5 per cent), ICT (3.5 per cent) and hospitality services (2.6 per cent). Agriculture's share in GDP has steadily fallen over the years and now accounts for just below 25 per cent of output in Uganda, with "food crops" accounting for half of that (at 12 per cent of GDP).¹ The share of the manufacturing sector in GDP stood at just over eight per cent in 2015 (UBOS 2016: 86). The construction sector, which is captured within the category of other industry, contributed to just over seven per cent of output in 2015.

Figure 2.4. Sectoral distribution of GDP



Source: World Bank 2016 World development Indicators

Figure 2.5 indicates how employment is distributed across the main sectors of the Ugandan economy. These data are drawn from the 2016/17 Uganda National Household Survey (Uganda Bureau of Statistics 2017), which proceeds along a new definition instituted by the ILO. Following the new definition, a person is counted as employed when this person (of working age) is engaged, during a short reference period, "in any activity to produce goods or services for pay or for profit" (Uganda Bureau of Statistics 2014: 45).² This implies that people for whom subsistence agriculture is their only activity are excluded from the data on employment (Uganda Bureau of Statistics 2014: 46).

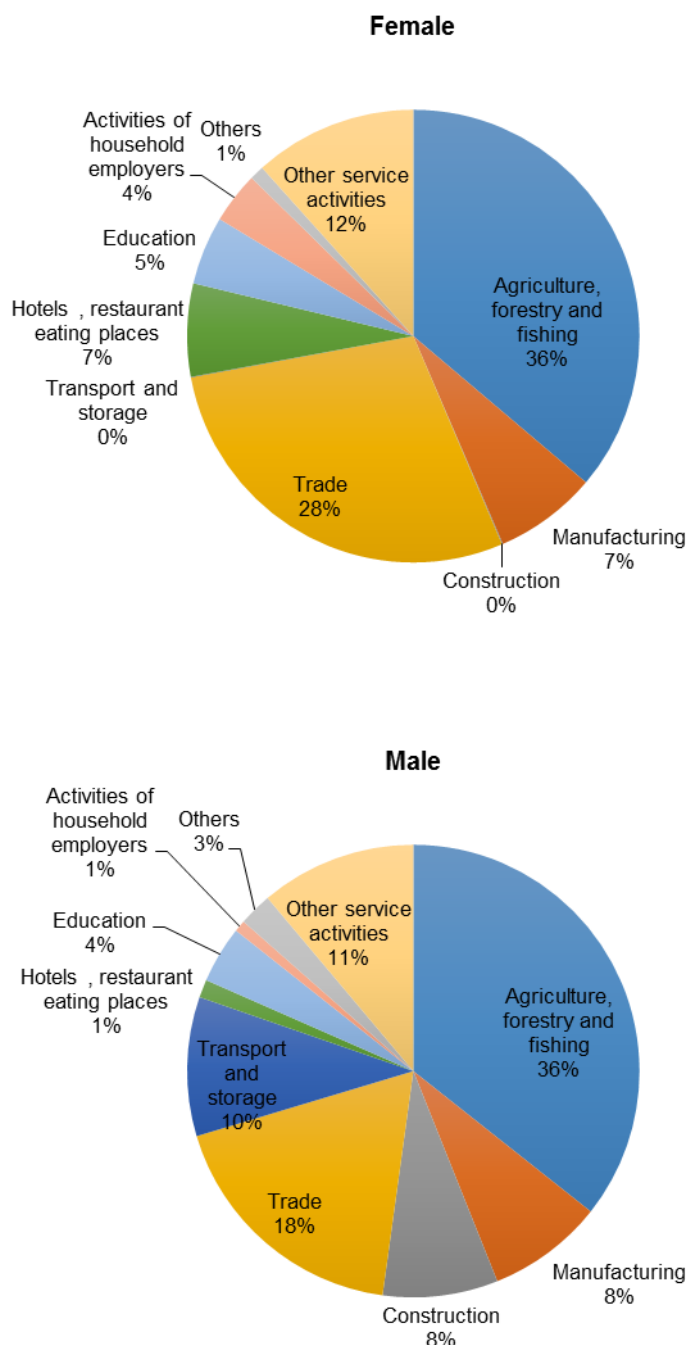
Following this new classification, services employ the bulk of those in work at 47.7 per cent of total employment. The largest category within services, in terms of employment is

¹ The other agricultural sub-sectors contributed to GDP (in 2015) in the following way: livestock accounts for 4.2 per cent of GDP, forestry for 4 per cent of GDP, fishing 1.6 per cent of GDP, and "cash crops" (which include coffee, cotton, tea, cacao, tobacco, sugar cane and horticultural products) together account for 1.7 per cent of GDP (UBOS 2016). These cash crops, however, account for a large share of export earnings (see below).

² Uganda Bureau of Statistics (2014: 46) adds that: "For pay or profit" refers to work done as part of a transaction in exchange for remuneration payable in the form of wages or salaries for time worked or work done, or in the form of profits derived from the goods and services produced through market transactions, specified in the most recent international statistical standards concerning employment-related income. (a) It includes remuneration in cash or in kind, whether actually received or not, and may also comprise additional components of cash or in-kind income. (b) The remuneration may be payable directly to the person performing the work or indirectly to a household or family member."

wholesale/retail trade (at 28 per cent for women and 18 per cent for men). This is followed by transport and storage for men (10 per cent for men and 0 for women) and hotels and restaurant for women (seven per cent for women and just one per cent for men). Agriculture accounts for 36 per cent of total employment and manufacturing for 7.9 per cent. Both these sectors have relatively equal gender shares. Construction accounts for 4.6 per cent of total employment, yet female employment here is negligible and the figure for men is eight per cent of total employment.

Figure 2.5. Employment by sub-sector and gender (%) in 2016/17 (new definition)



Source: UBOS, UNHS 2016/17

A JoGGs exercise (see Bargawi and Van Waeyenberge 2018) confirms the lack of absorption of workers in high productivity sectors in the recent past. Instead, the low productivity agricultural and services trade sectors continue to provide a source of employment for existing and new workers in Uganda. The labour market participation rate in Uganda is around 72 per cent and is higher for men (81 per cent) than women (65 per cent) (Uganda Bureau of Statistics 2017). Of the labour market participants, around 90 per cent are in employment (and rest counted as unemployed). Around 49 per cent of those in employment are waged workers, while 35 per cent are self-employment and the rest are counted as contributory family workers or employers. For waged workers, the vast majority (90 per cent) are employed in the private sector (Uganda Bureau of Statistics 2017).

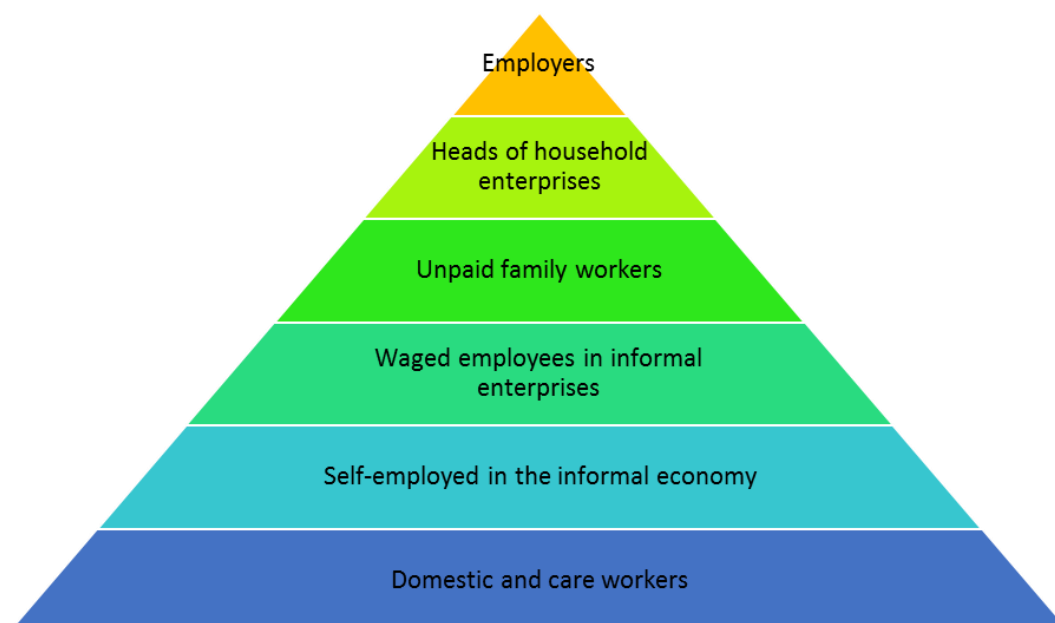
A pervasive feature of the Ugandan labour market is its high level of informality, with formal employment making up less than 14 per cent of total employment (Uganda Bureau of Statistics 2017). Informal workers can be employed in both formal and informal enterprises but are characterised by the fact that they are not subject to national labour legislation, income taxation or social protection and are not able to access certain employment benefits (e.g. paid annual or sick leave, etc.) (Uganda Bureau of Statistics 2017).³ Uganda is not unique in being characterised by high rates of informal employment (Taylor and Rioux 2018), and it is often remarked that across industrialised as well as emerging economies, informal employment is on the rise (Bremman and van der Linden 2014).

In Uganda, surveys have only recently begun systematically to record information on informality. The 2009/10 UNHS survey, for example, found that 67 per cent of people employed outside the agricultural sector were employed informally (Uganda Bureau of Statistics 2011: 42). This is not comparable to the recent data which includes the agricultural sector and puts the national figure at around 86 per cent, with higher rates of informal employment for young people (95 per cent) (Uganda Bureau of Statistics 2017). A consideration of sector-based production statistics is also illuminating. Informal manufacturing activities have risen from around a third of all manufacturing activities in the late 2000s to half of the entire manufacturing sector in the 2016/17 survey (Uganda Bureau of Statistics 2009; Uganda Bureau of Statistics 2016; Uganda Bureau of Statistics 2017).

Rates of informal employment tend also to be higher for women than men, although a common “iceberg” view of the economy has resulted in much of the informal domestic and care work done by women not being systematically recorded (Kabeer 2008). This is also the case in Uganda where information on unpaid work is scant. Given the extent of the informal economy and informal employment in Uganda, it is useful to break down and differentiate between types of economic activities and the conditions of work across the informal economy. Figure 2.6 is adapted from Taylor and Rioux (2018) and Kabeer (2008) and moves from those at the bottom end of the informality pyramid (with the worst working conditions and pay) to those at the top where conditions and pay are similar to the formal economy.

³ Informal employment is defined “as comprising of the total number of informal jobs, whether carried out in formal sector enterprises, informal sector enterprises, or households, during a given reference period. Informal employment identifies persons who are in precarious employment situations irrespective of whether or not the entity for which they work is in the formal or informal sector. Persons in informal employment therefore consist of all those in the informal sector; employees in the formal sector; and persons working in private households who are not entitled to basic benefits such as pension/retirement fund, paid leave, medical benefits, deduction of income tax (PAYE) from wages and whose employment agreement is verbal” (Uganda Bureau of Statistics 2011: 33).

Figure 2.6. The Informal Economy Pyramid



Source: Adapted from Taylor and Rioux 2018 and Kabeer 2008

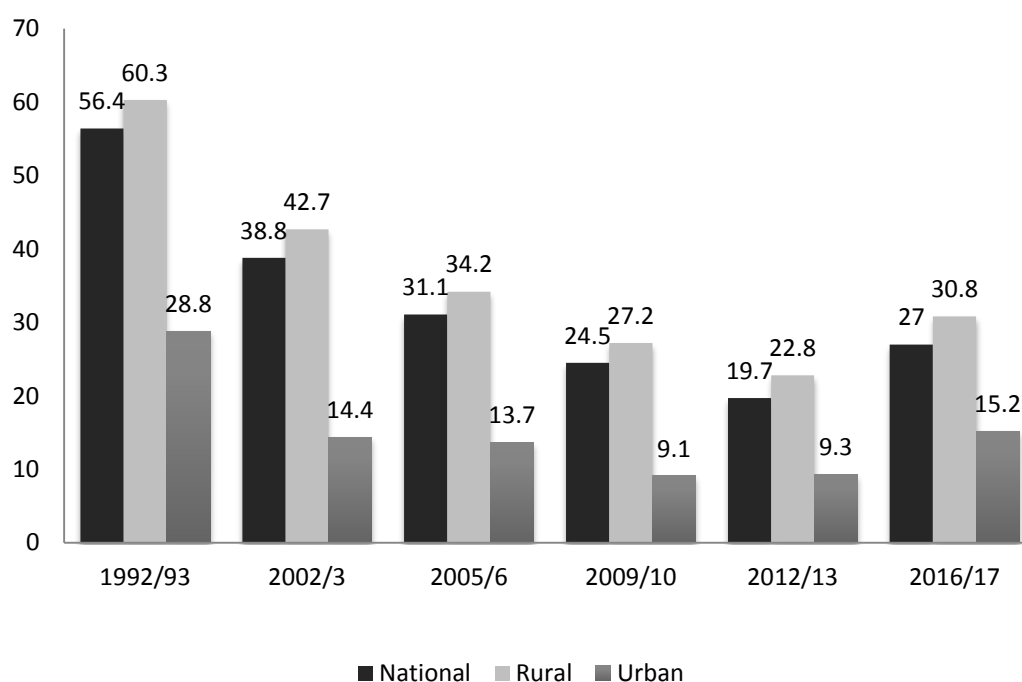
Unpacking this picture further reveals an underlying gender division in paid and unpaid work in Uganda. A survey conducted by ActionAid (Budlender and Moussié 2013) found that Ugandan men spend, on average, three times as much time on paid work when compared to women. Women, on the other hand, spend at least three times as much time caring for children and housework as their male counterparts. The inequalities in paid and unpaid work between men and women may therefore be more pronounced than implied by the time-use components of the 2009/10 and 2012/13 UNHS which identify more modest differences in men and women's time-use patterns. (Uganda Bureau of Statistics 2011; Uganda Bureau of Statistics 2014).

In addition to informality, underemployment and working poverty are pervasive features of the Ugandan labour market and labour under-utilisation is particularly acute in the agricultural economy (see Bargawi and Van Waeyenberge 2018). Dumas and Houdre (2016) present evidence of high degrees of involuntary part-time employment, with 26 per cent of those currently in part-time employment in Uganda seeking more hours of work to increase their income. These features have resulted in rates of working poverty that have increased in recent years. The proportion of those in employment but whose incomes fell below the national poverty line was roughly 13 per cent nationally in 2016/17, rising from seven per cent in 2012/13. This figure is significantly higher for those in rural areas and double the national average for Eastern and Northern regions. It is also higher for the self-employed and those working in the agricultural sector (Uganda Bureau of Statistics 2017).

Finally, wages in Uganda have remained low by international standards and are lower than in Tanzania and Kenya (Gelb, Meyer et al. 2013). This may reflect the absence of a minimum wage in Uganda. Furthermore, national-level household survey data reveal that monthly wages have, on average, remained stagnant in real terms since 2005/06, with persistent gaps between wages in the public and private sectors and growing gaps between urban and rural wages and those received by men and women (see Bargawi and Van Waeyenberge 2018). Kasirye (2011) finds significant gender gaps in the private sector and for employees in the informal sector where women earn around 40 per cent less than male counterparts (see also Dumas and Houdré 2016: 13).

Uganda has however made progress in reducing poverty over the 1990s, 2000s and 2010s and achieved the MDG target of halving the proportion living below the national poverty line ahead of the 2015 deadline. But in the past few years, poverty has been creeping up, in both rural and urban areas, putting into question Uganda's ability to meet the SDG 1 target of eradicating extreme poverty by 2030 (see figure 2.7). While the number of people living below the national poverty line had decreased from 9.8 million in 2002/03 to 6.7 million in 2012/13 (Ministry of Finance Planning and Economic Development 2014), this has subsequently increased to 10 million between 2012/13 and 2016/17 (Uganda Bureau of Statistics 2017). Rural areas have historically had significantly higher poverty levels than urban areas, with poverty particularly acute in the Northern and Eastern parts of the country (World Bank 2016).

Figure 2.7. Headcount poverty (national poverty line), by rural and urban (1992/93 — 2016/17, selected UNHS years)



Source: UNHS Reports, UBOS (various)

Over the 1990s and 2000s, reductions in overall poverty were achieved via decreases in both rural and urban poverty. However, since 2009/10, urban poverty reduction has increased to levels above those of the early 2000s, partially as a result of higher food and fuel costs (World Bank 2016). The recent sharp increase in poverty has particularly affected the Eastern region of Uganda and can be linked to the general growth slow-down as well as severe droughts and continued staple food price rises in the last two to three years (Uganda Bureau of Statistics 2017).

Income inequality in Uganda has followed a different trajectory to that of poverty reduction (Oxfam 2016). The Gini coefficient increased over the 1990s to reach 0.43 in 2002/03 and remained around 0.41-0.43 for most of the 2000s and 2010s. However, the most recent UNHS survey indicates a reduction in income inequality with the Gini at 0.37 for the country as a whole. This reduction appears to have been driven by reductions in inequality across some of the poorest regions in Uganda (Karamoja, Busoga and Eastern regions) while income inequality in Kampala went up (see table 2.1).

Table 2.1. Gini Coefficient by Region (2002/03 — 2016/17)

	2002/03	2005/06	2009/10	2012/13	2016/17
Kampala	0.47	0.39	0.43	0.35	0.39
Central 1	0.44	0.42	0.46	0.40	0.38
Central 2	0.35	0.35	0.38	0.36	0.32
Busoga	0.38	0.36	0.33	0.37	0.31
Eastern	0.35	0.35	0.31	0.33	0.29
Mid-Northern	0.35	0.33	0.34	0.37	0.37
Karamoja	0.44	0.40	0.51	0.43	0.33
West Nile	0.28	0.32	0.31	0.34	0.29
Mid-Western	0.35	0.33	0.33	0.33	0.35
South-Western	0.36	0.35	0.40	0.34	0.36
National	0.43	0.41	0.43	0.41	0.37

Source: UBOS (2017)

3. Insufficiencies of structural transformation

Structural transformation in terms of a change from an economy dominated by subsistence agriculture to an economy characterised by commercial agriculture and a sizeable manufacturing sector has insufficiently materialised in Uganda, see also (Kjær and Katusiimeh 2012). Yet, the country's high population growth rate (at 3.3 per cent per year for the working age population), together with other challenges including those deriving from climate change, make structural transformation urgent.

The main underlying reason for the insufficient structural transformation and the concomitant lack of expansion of productive employment in Uganda is the failure to develop and expand rapidly the productive capacity in sectors that can absorb the fast growing labour force in productive employment. This has combined with a failure to accelerate agricultural upgrading and reflects failures to raise the share of manufacturing value added in GDP, which remains persistently low at 8.5 per cent of GDP in 2015. This is below the (low) average for SSA (at 10.5 per cent for the period 2000 to 2014, down from 11.9 per cent during the 1990s) (Mijiyawa 2017).⁴ Haraguchi et al. (2017), however, remind us of the continuing crucial role of manufacturing in growth and development, including for low-income countries.⁵

While there are manifold drivers for the lack of structural transformation, we focus here on the combination of a fragmented and weak private sector with a historically insufficient public investment programme. The private sector has been designated through government policies as the main engine of development and growth but has failed to perform its assigned transformative role. These realities have interacted with a persistently narrow integration into the global circuits of global production and trade, as Uganda's exports remain biased towards agro-commodities (despite a fall in their share of exports over the last decade, see below). We briefly discuss each of these issues and our assessment joins Brownbridge and Bwire (2016) who discuss the constraints on structural transformation in Uganda along similar lines.

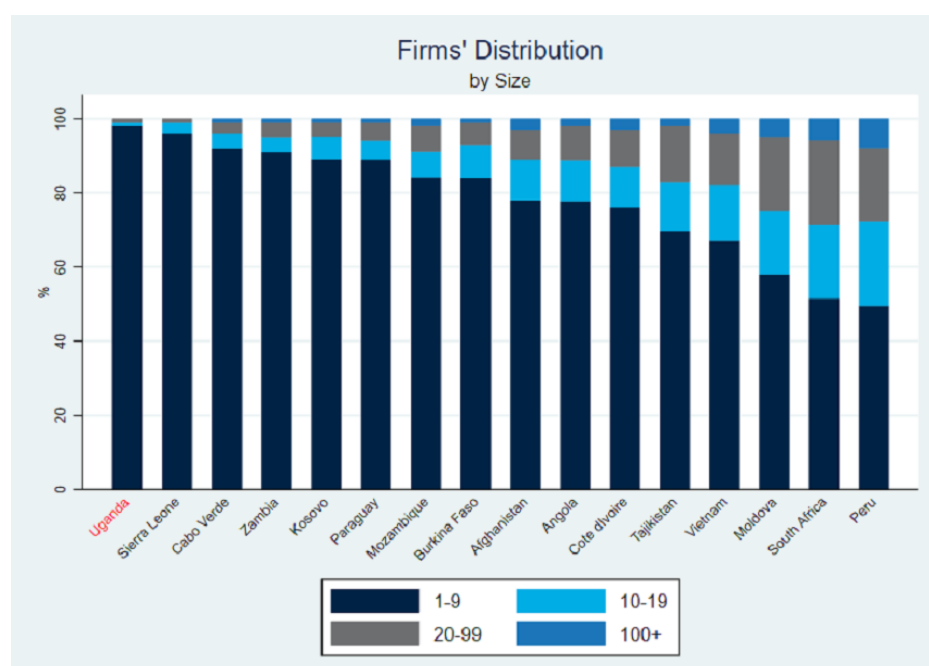
3.1 The state of the private sector in the Ugandan economy

Overall, the Ugandan economy is dominated by small (and mostly informal) enterprises. This can be illustrated on the basis of the Uganda's Business Register for 2001/02 and 2010/11. These indicate how the number of business in Uganda has proliferated over the period 2001/02 to 2010/11, from 161,000 to 458,000. At the same time, the average number of employees per firm has shrunk from 2.8 to 2.3. Compared to other countries, the Uganda's firm structure stands out as particularly skewed.

⁴ See Mijiyawa (2017) and Haraguchi et al. (2017) for recent restatements of the strategic role of manufacturing in the development process.

⁵ Haraguchi et al. (2017: 306) explicitly assert that: "country level observations lend ... additional empirical support to the premise that manufacturing development has remained important for fast, sustained growth after 1990, and that this path has not been closed to even small or landlocked countries in recent year. China seems to have reached the peak in terms of output and employment in the cloth ... industry. As the country upgrades its industrial structure and moves out of labor-intensive industries, space for industrialisation may open further for low-income countries if the right policies are implemented".

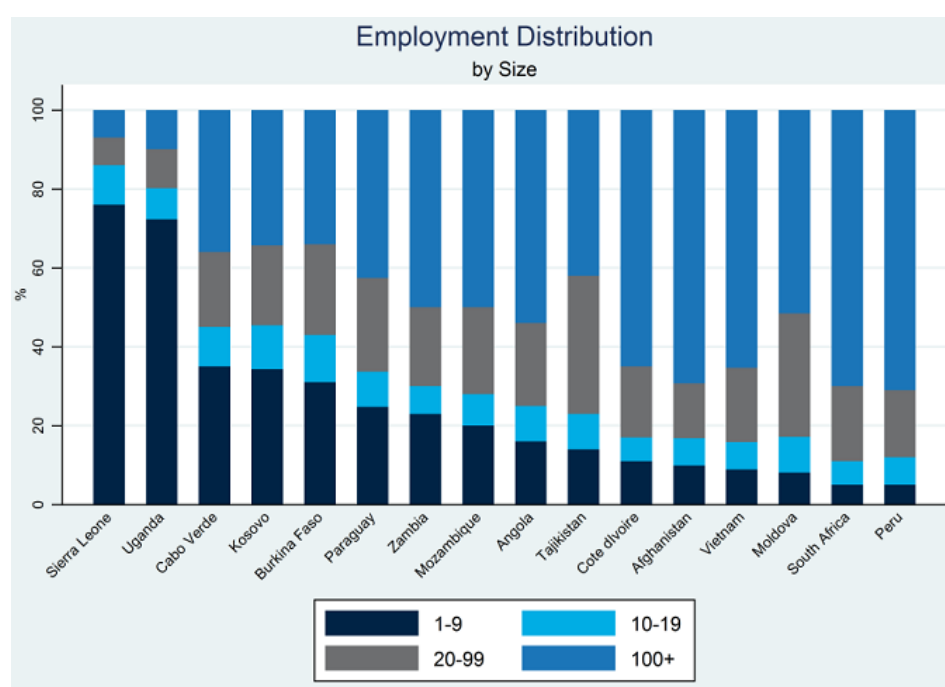
Figure 3.1. Firms' distribution by size, selection of countries



Source: World Bank (World Bank 2017: Slide 66)

This equally reflects in the skewed distribution of employment across size of firms when compared internationally.

Figure 3.2. International comparison employment distribution across firm size



Source: World Bank (2017: slide 67).

Furthermore, the growth in businesses between 2001/2 and 2010/11 has been driven by entry of own-account workers and firm failure is high. Only 24 per cent of the firms established in 2001 (and recorded in the Census) were still operational after nine years. There are, however, significant variations across industries, with nearly half of manufacturing start-ups surviving their first nine years as compared to only 22 per cent for new firms in the services sector (Kiranda, Walter et al. 2017: 51).

The activities in which new businesses have been established are predominantly in the trade sector, where the average number of employees is lowest at around 1.6 employees per business. This has remained largely unchanged since 2001/02. In contrast, the employment share of manufacturing sector businesses, roughly at 20 per cent in 2001/02, has been reduced to 13 per cent by 2010/11. This concurs with other findings regarding the Ugandan business landscape, which suggest that the establishment of new enterprises has been driven by negative push factors in sectors with relatively low barriers to entry, rather than in sectors with strong growth potential (Ministry of Finance Planning and Economic Development 2014). This has led half of the country's entrepreneurial activity to be classified as "necessity-driven" (Ministry of Finance Planning and Economic Development 2014: 15). This is the highest proportion for sub-Saharan Africa. For MOFPED, the Ugandan private sector landscape is characterised by the "missing middle", as there are very few firms with several paid employees compared to a large number of small and micro enterprises with limited job creation and growth potential. Further, employment growth among larger firms has been extremely low.

The government's first National Development Plan (NDP I) demonstrated an acute awareness of the weak and fragmented state of the Ugandan private sector and conceded that the rapid growth in (small) enterprises, which are focused on low-value services, is "unlikely to be a platform for significantly transforming the economy" (Government of Uganda 2010: 24). The 2015 Human Development Report for Uganda (UNDP 2015: 123) puts this as follows:

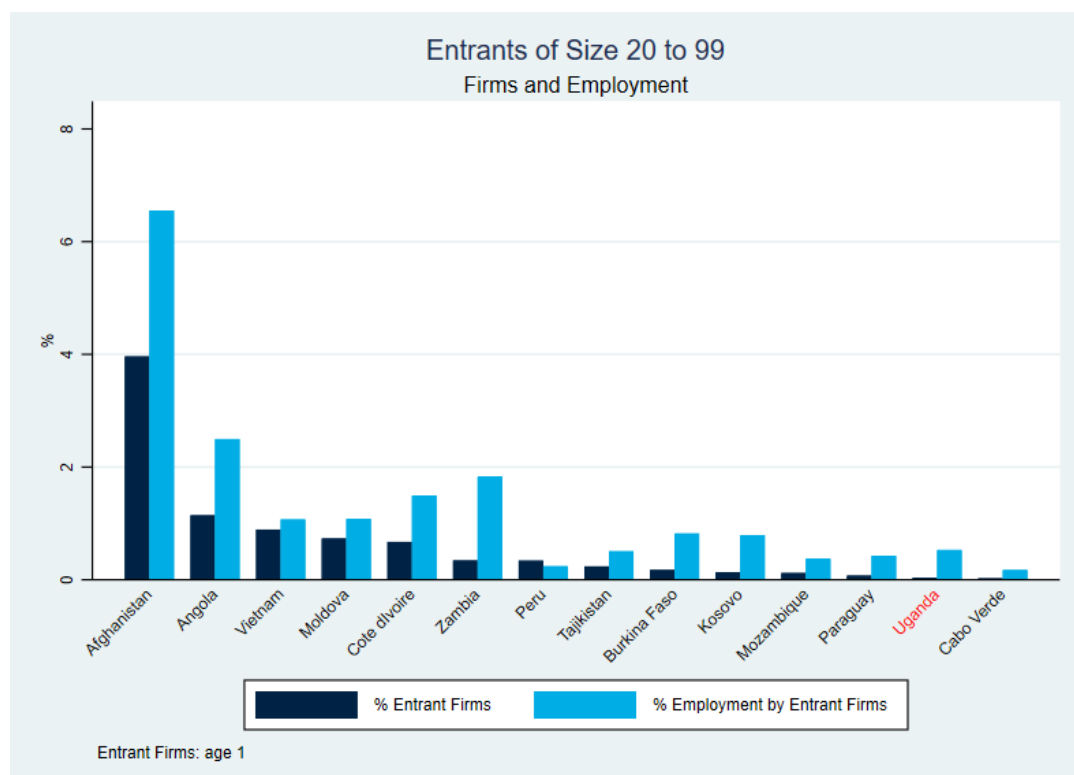
Uganda's private sector is dominated by informal micro, small and medium enterprises (MSMEs). Most of these operate as *jua kaali* ("hot sun") enterprises with no formal business premises, no record-keeping, and limited access to bank credit. Roughly 65 per cent of these die before celebrating their fifth birthday. This implies one thing. The rhetoric of private-sector led development in Uganda hardly stands up to scrutiny. The fragilities in Uganda's private sector present a strong case for strategic State guidance of wealth creation, job creation and economic transformation.

The World Bank (World Bank 2013: xviii), also, emphasises that:

Large firms can drive a rapid increase in employment because they drive transformative productivity growth and have significant potential to support a higher level of integration with regional and global economies.

World Bank (2013) further highlights that while existing large firms in Uganda were downsized as a result of the privatisation programmes implemented during the 1990s and 2000s, very few new large firms have been established since then (see also Figure 3.3).

Figure 3.3. International comparison of entry and employment of medium and larger firms



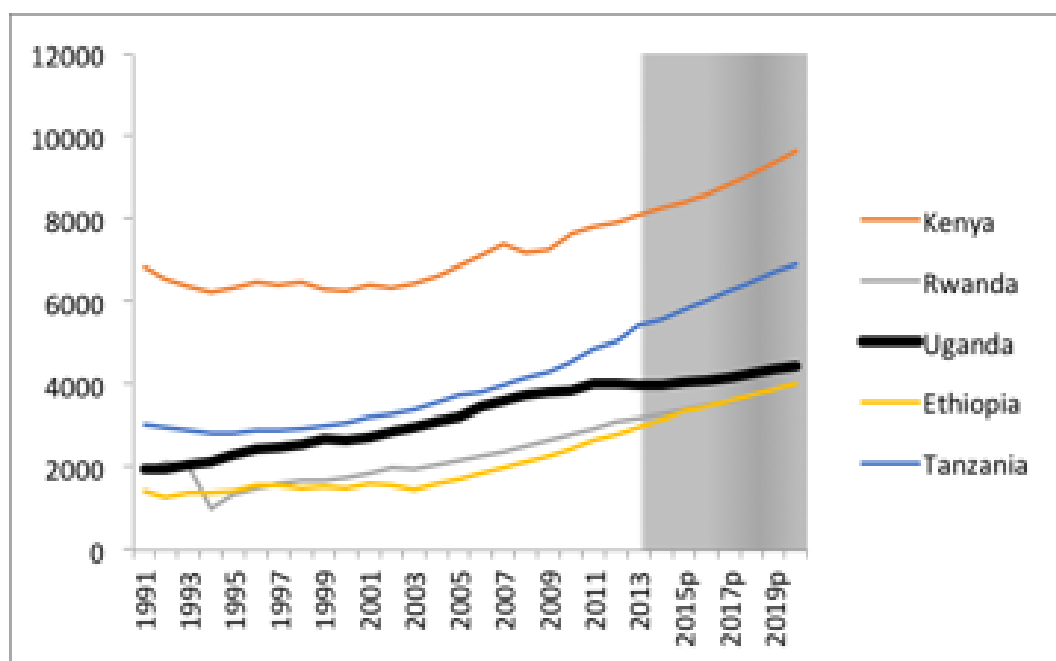
Source: World Bank (2017: slide 69).

These observations raise the challenge of finding ways to support the growth of medium and larger firms (that employ more than 20 individuals) through strategic interventions. They also raise issues regarding the hazards of a development strategy that relies on the private sector, when the latter is weak, fragmented and, in general, unable to undertake the large-scale, long-term investments that the fast upgrading and up-scaling of the productive base of the Ugandan economy requires. It is indeed common that in the presence of widespread market failures (for instance, as a result of poor infrastructure), a weak private sector is more likely to seek rapid returns through activities like trade, finance and real estate, rather than invest in productive sectors that are essential for long-term development (Oqubay 2015: 95). Deploying a political economy-lens, Kjær and Katusiimeh (2012: 12) support the argument that Uganda's capitalist class is weak and that the wealthiest have mainly derived their wealth from trade, imports, distribution or the service sector (mainly hotels and mobile phone services) rather than manufacturing.

The general landscape of the weakness of the private sector reflects in a poor productivity record for the Ugandan economy, in particular when compared to regional peers. Figure 3.4 provides a regional comparison of trends in output per worker as a measure of labour productivity across the region over the last two decades and situates Uganda somewhere in the middle. However, despite progress in raising productivity since 1991, Uganda's productivity growth has stagnated since 2011 (and going forward to 2020).⁶ This is particularly stark when compared to the trajectory of some of its neighbours. Rwanda and Ethiopia, for instance, with historically lower levels of output per worker, are rapidly catching up with Uganda, displaying steady productivity growth since the early 2000s.

⁶ See also Brownbridge and Bwire (2016: 8-10) for a discussion of changes in labour productivity in Uganda between 2002/3 and 2012/13.

Figure 3.4. Output per worker (GDP constant 2011 international \$ in PPP)

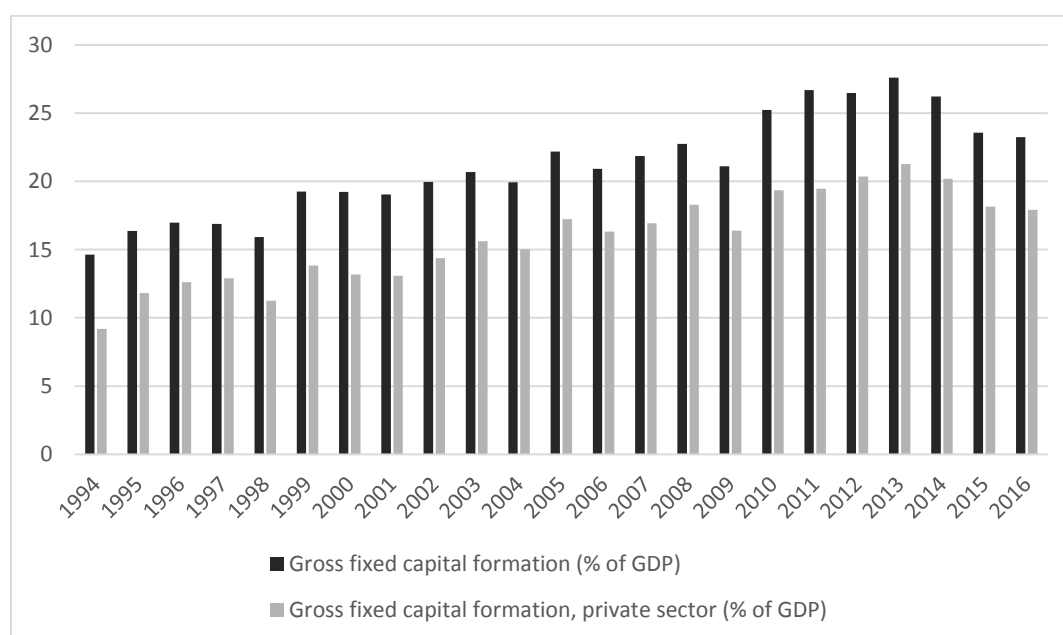


Source: ILO, KILM (2016)

3.2 Insufficient productive capacity creation

Underlying the trends of insufficient generation of productive employment are historically inadequate investment levels. Investment levels only increased moderately during the 2000s. They have increased more rapidly since 2009, but gross fixed capital formation as a share of GDP only briefly exceeded 26 per cent of GDP and has started falling since 2014 (see Figure 3.5).

Figure 3.5. Total (and private) gross fixed capital formation as a share of GDP



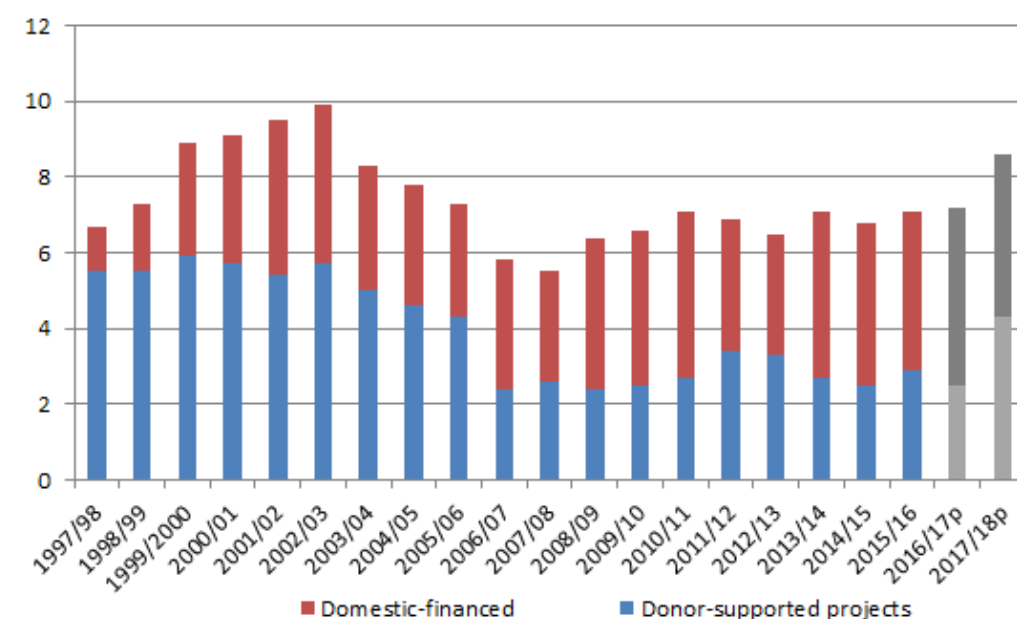
Source: World Development Indicators (2017)

When compared to neighbouring countries and the SSAn average, real growth of capital formation in Uganda also performs particularly poorly. World Bank (World Bank 2017: 19) documents that while in the period between 2012/13 and 2014/15 Uganda's gross capital formation increased at an average rate of 1.7 per cent per annum this "was far lower than increases recorded by neighbouring countries, including Rwanda (8.3 per cent) and Tanzania (6.2 per cent) and less than half the average for sub-Saharan Africa (at 4.7 per annum)" (our emphasis). Further, Brownbridge and Bwire (2016: 15) highlight that most of the investment increase between 2009 and 2014 has been in residential and commercial buildings and oil exploration. Investment in residential buildings alone accounted for nearly 40 per cent of private sector investment during this period (ibid). The authors add that:

The large firms covered by the PSIS [private sector investment survey], which have probably accounted for most of the investment undertaken by formal sector firms outside of the oil sector, undertook investment equivalent to just over 3 per cent of GDP during 2011-2014. It is these firms which provide the bulk of high productivity jobs in the economy. They are not investing enough and, therefore, not expanding quickly enough, to absorb more than a miniscule share of the labour force.

There are various reasons for inadequate investment levels. These include: inadequate infrastructure; high cost of credit; insufficient crowding in through public investment; and the traditional trap of low level of GDP generating weak aggregate demand prospects (see Bargawi and Van Waeyenberge 2018). This raises the urgent need for concerted, comprehensive and targeted efforts to increase investment levels in the country, both in the public and private sector (see below). While public investment as a share of GDP has increased since 2009, it currently hovers at around 7 per cent of GDP. This follows a steep decline in the early 2000s and remains far below levels attained in the late 1990s (see Figure 3.6).

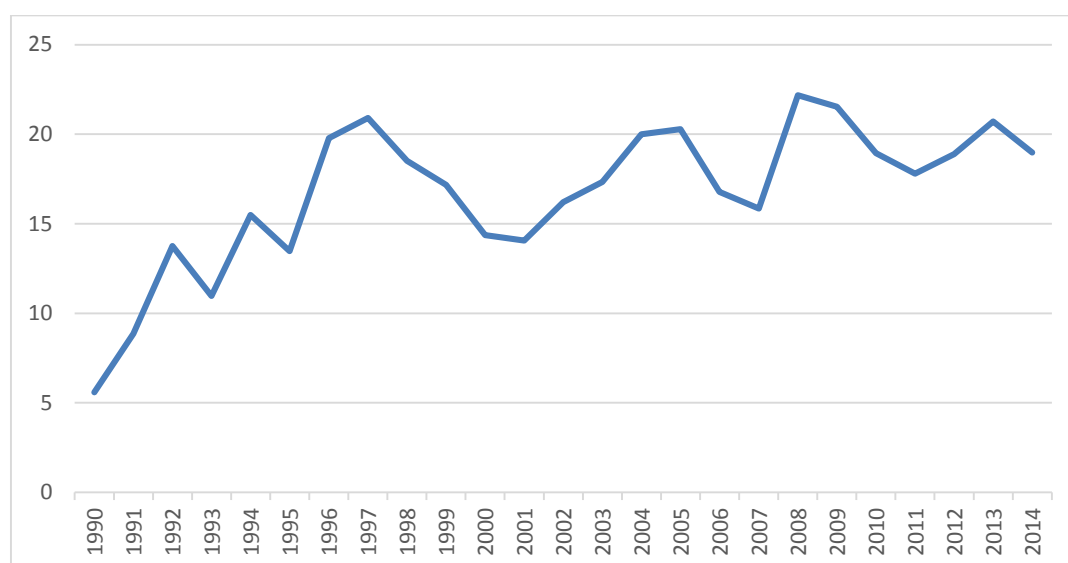
Figure 3.6. Development expenditures as share of GDP



Source: IMF Article IV Consultations (various)

Resources for investment are mobilised either domestically or through external resources. In terms of domestic resources, savings have been insufficient in Uganda. Figure 3.7 indicates how these have stagnated since the mid-2000s and how they have remained beneath 20 per cent since 2010.

Figure 3.7. Gross Savings as share of GDP



Source: World Development Indicators (2017)

In general, the 2016 UNCTAD Least Developed Countries Report (p. ii) recognizes the challenge of raising savings rates in a country like Uganda due to:

the external resource gap facing the country, the complexity of its development challenge, its narrow tax base, the inadequacies in tax collection and administration, the resources forgone due to illicit financial flows and the insufficient development of the domestic financial sector.

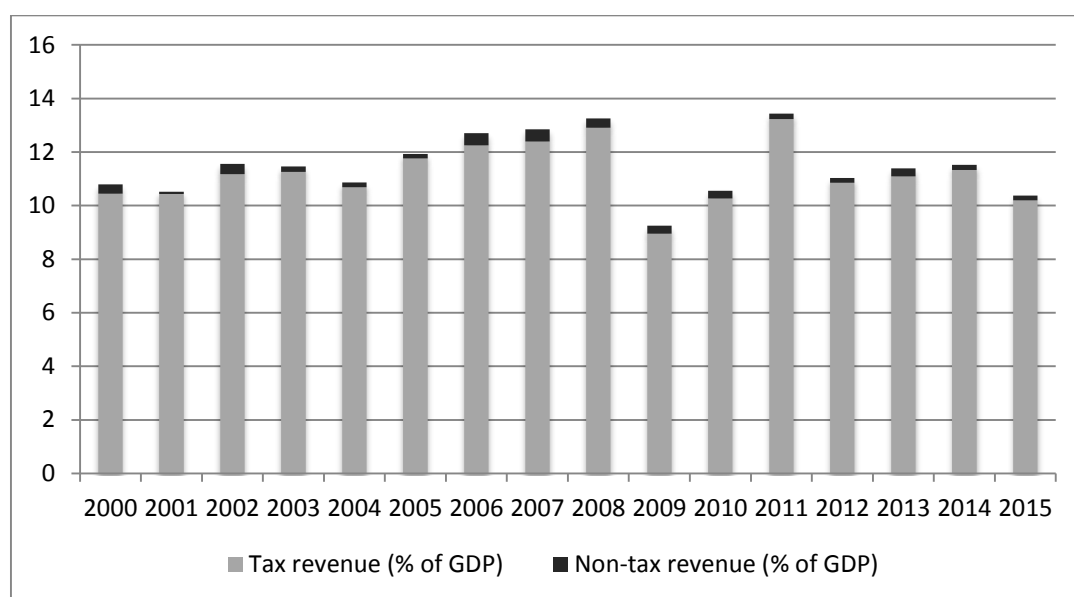
The Report adds that “[i]f LDCs are to raise their fixed investment, as is essential for structural transformation, the deficit will inevitably widen in the coming years, particularly in view of the enormous financing needs associated with the Sustainable Development Goals”. For Matovu (2010) weak private savings rates in Uganda are related to a set of structural features, including the practice of holding savings in non-financial assets making them less readily available for long-term and large-scale investments. This is compounded by a formal banking sector that is characterised by weak competition and high spreads (with low rewards for savers), see below.

Weak domestic saving efforts have been accompanied by insufficient domestic resource mobilisation through the state. Figure 3.8 indicates how revenue mobilisation by the state has stagnated at very low levels below 14 per cent over the last decade.⁷ This compares unfavourably to revenue mobilisations in Tanzania, Kenya and Rwanda all of which are either close to or in excess of 20 per cent of GDP (Government of Uganda 2015: Table 5.10). The Ugandan state has also not taken recourse to more heterodox ways of mobilising forced savings, for instance through rent-appropriations generated by state ownership of strategic sectors in the economy.⁸

⁷ See (Kangave and Katusiimeh 2015) for an in-depth account of the various actors bearing on tax policy in Uganda.

⁸ See (Clapham 2017) on rent-seeking in support of essential capital for infrastructural projects through state access to monopoly rents in telecommunications in Ethiopia.

Figure 3.8. Revenue mobilisation (tax and non-tax revenue) as share of GDP, 2000-2015

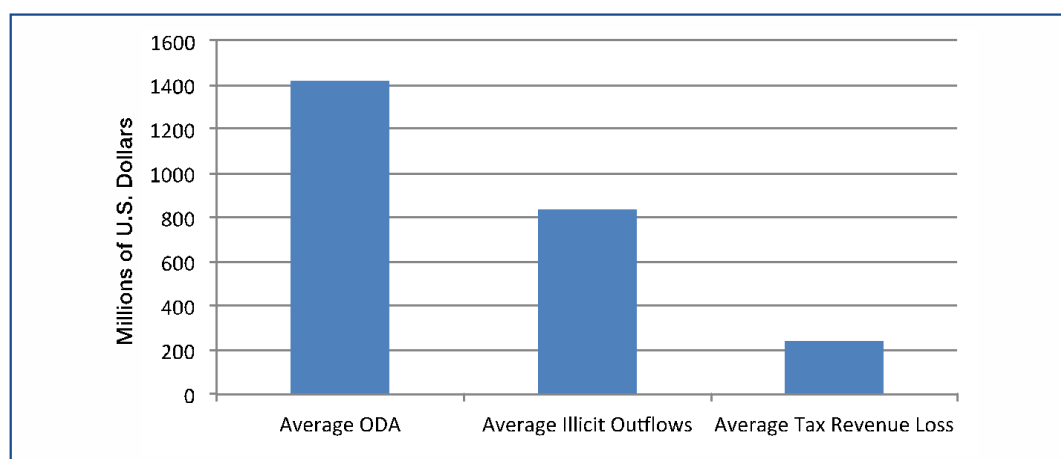


Source: World Development Indicators (2017)

These weak revenue mobilisation efforts have been compounded by significant illicit outflows from Uganda. These have mainly been facilitated through trade mis-invoicing (particularly import-over-invoicing). Global Financial Integrity (2014) estimates that for the period 2002 to 2011, gross illicit capital outflows from the country amounted to an annual average of around seven per cent of GDP.⁹ Global Financial Integrity (2014) finds that illicit outflows through import over-invoicing have been steadily increasing from \$275 million in 2002 to \$1.75 billion in 2011. With a corporate tax rate in Uganda of 30 per cent, Global Financial Integrity (2014: 38) calculates that the average amount of annual lost tax revenue could be in the region of \$243 million and for 2011 it could have reached \$524 million, which for that year corresponded to around 77 per cent of the government deficit. Figure 3.9 compares annual average ODA inflows to annual average illicit outflows and annual lost tax revenues to put these numbers in stark perspective.

⁹ Trade mis-invoicing through import over-invoicing is a common way to facilitate illicit capital outflows. Trade mis-invoicing refers to “the intentional misstating of the value, quantity, or composition of goods on customs declaration forms and invoices, usually for the purpose of evading taxes or laundering money” (Global Financial Integrity 2014:1). There are four basic categories of trade mis-invoicing: import under-invoicing, import over-invoicing, export under-invoicing, and export over-invoicing. Global Financial Integrity (2014: 38) explains how import over-invoicing has two broad appeals to corporations operating in developing countries. “First, it allows them to circumvent capital controls in order to keep valuable foreign exchange outside the country... Second, considering that over-inflated costs of imports result in lower profit margins, corporations can significantly lower their taxable income”.

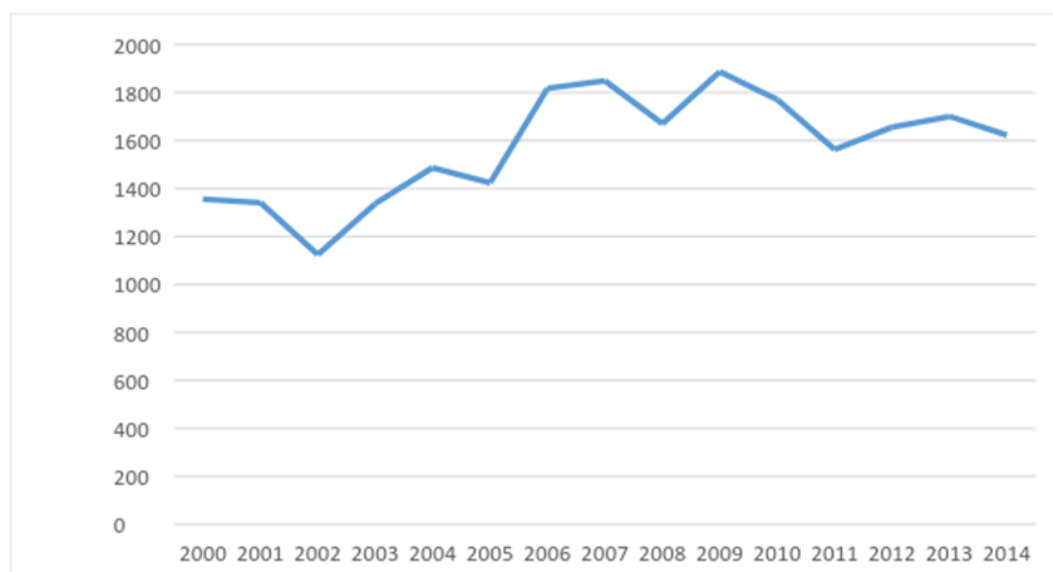
Figure 3.9. Annual average ODA versus average illicit outflows versus average tax revenue loss, 2002-2010 (in millions of U.S. dollars), Uganda



Source: Global Financial Integrity (2014)

In terms of access to external resources, the Ugandan economy has seen a stagnating flow of ODA (see Figure 3.10).

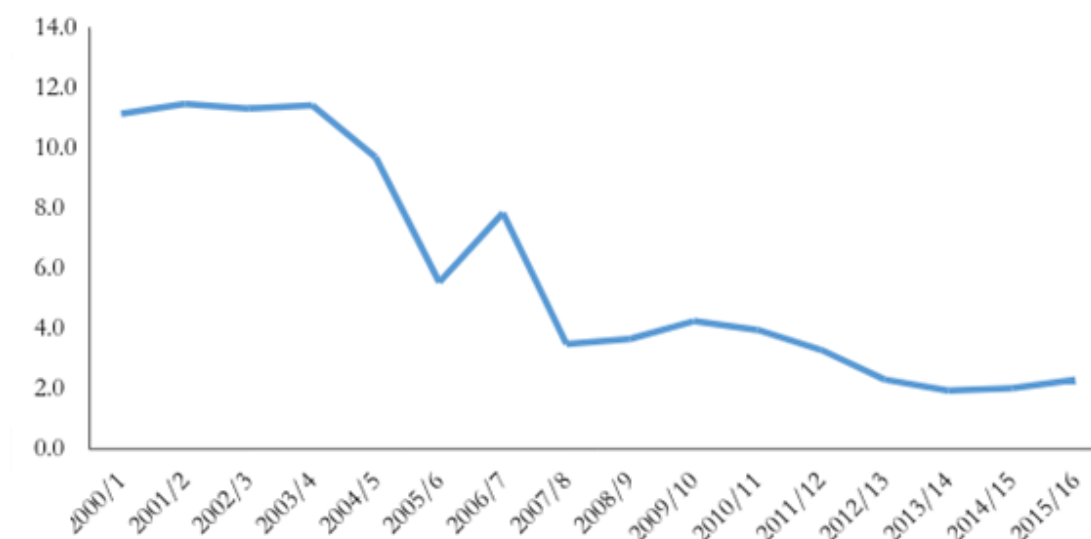
Figure 3.10. Net official development assistance and official aid received by the Government of Uganda (constant 2013 US\$ millions)



Source: World Bank 2017 World Development Indicators

This has reflected in a rapidly falling share of GDP over the last decade (see Figure 3.10), dropping from above 10 per cent of GDP in the early 2000s down to almost two per cent of GDP in 2015/16 (see Figure 3.11).

Figure 3.11. Aid as share of GDP



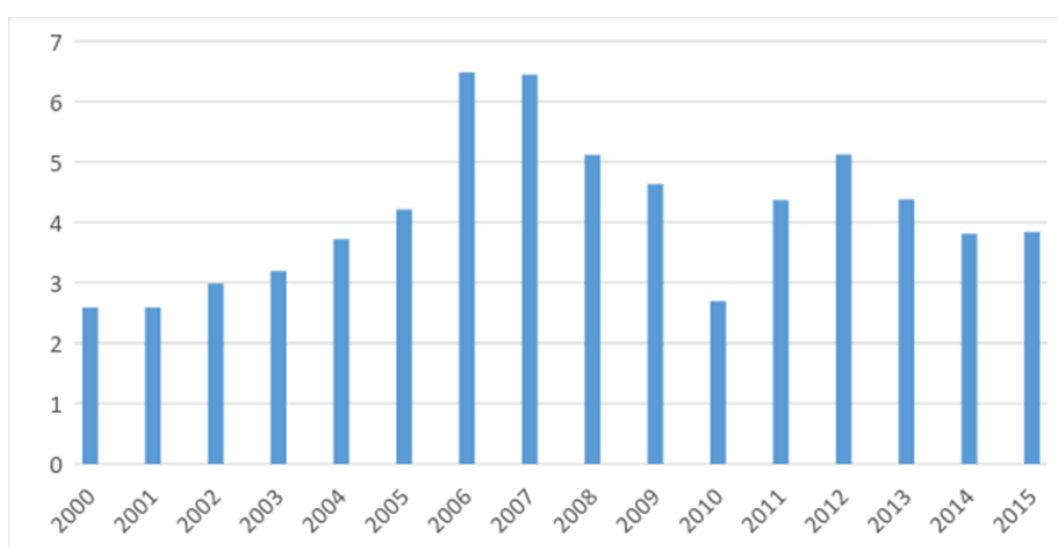
Source: Bank of Uganda (2016)

Mawejje and Munyambonera (2017: 2) observe that:

The changing external development landscape implies that cheaper and patient concessional funds that can be invested in infrastructure are no longer readily available. Development financing from traditional donors, particularly grants, has significantly decreased. New partners such as China are willing to provide Uganda with the funds required for major infrastructure developments significantly beyond what the traditional partners have been willing to offer but at terms that are more commercial.

Finally, FDI has followed a similar pattern. Following steady increases in FDI (as a percentage of GDP) over the early 2000s, FDI into Uganda has been negatively affected by the global economic crisis in 2008-2010. The recovery of FDI since 2010 has been weak, with the share of FDI in GDP in 2015 equal to that in 2004 (see Figure 3.12).

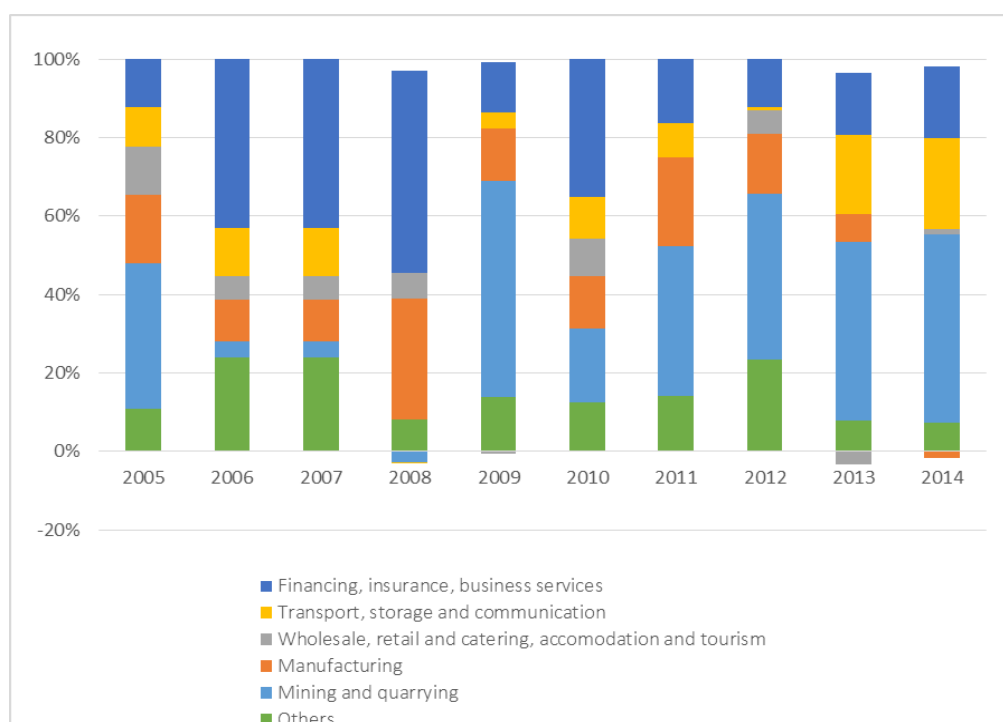
Figure 3.12. Foreign direct investment, net inflows (per cent of GDP)



Source: World Development Indicators (2017)

Considering the main sectoral recipients of FDI in Uganda, there has been a shift away from flows to the manufacturing and financial services sectors and towards the mining sector, particularly since the global financial crisis. This is reflected in FDI stocks by sector, as depicted in Figure 3.13.

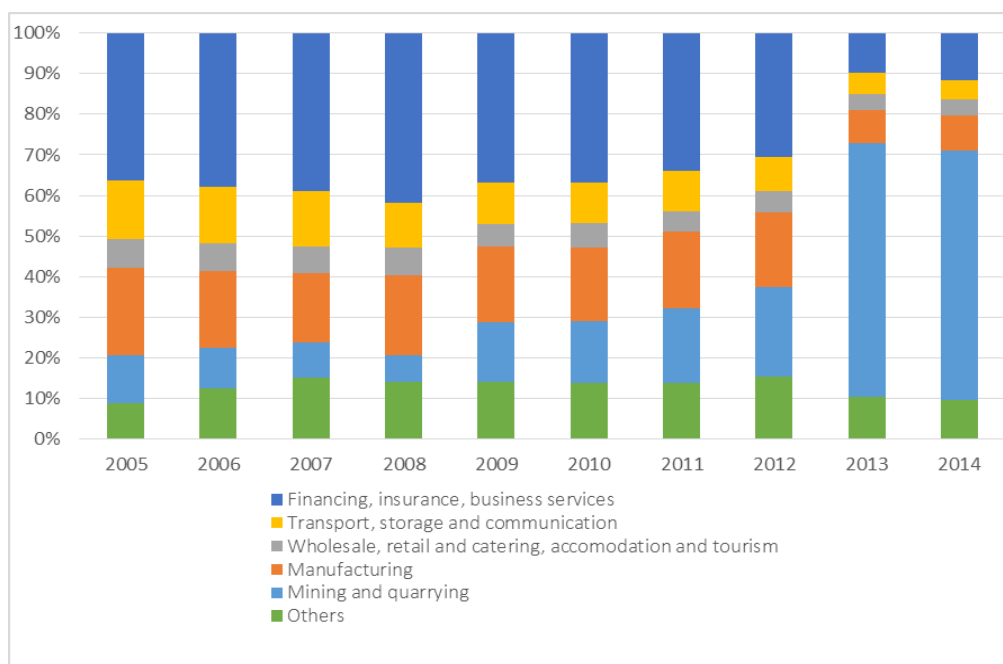
Figure 3.13. Foreign direct investment flows by sector (2005-2014)



Source: Bank of Uganda (2016)

Figure 3.14 indicates that, in 2014 almost two thirds of all FDI stocks (61 per cent) in Uganda were held in the mining and quarrying sector. This compares with a figure of around 15 per cent in 2009.

Figure 3.14. Foreign direct investment stocks by sector (2005-2014)



Source: Bank of Uganda (2016)

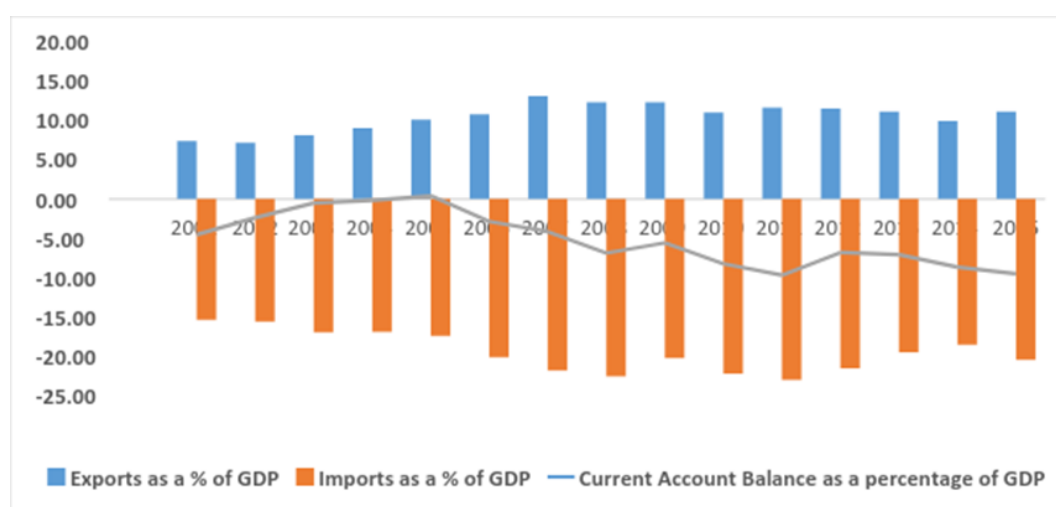
3.3 Lopsided integration in global trade

The lack of structural transformation and expansion of opportunities for productive employment is also strongly related to the nature of the integration of the economy in the world economy. Weeks (2004) 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 2000s. In the context of a heavy reliance on imports, this has implied a persistent gap between imports and exports (see Figure 3.15).

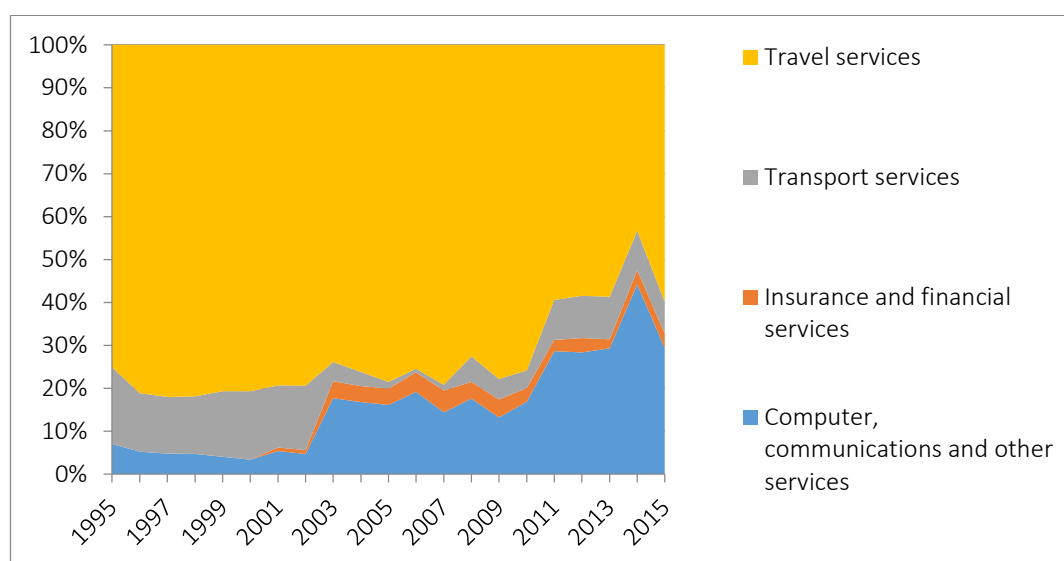
Figure 3.15. Uganda's current account balance – exports, imports and balance (1990-latest year)



Source: Bank of Uganda, 2016

There has however been growth in services exports over the past twenty years. As a share of total exports (in value terms), services have risen from below 20 per cent in 1995 to 46 per cent in 2015 (World Bank 2017, WDI). Within the services sector, tourism (travel services) has historically dominated services exports (see Figure 3.16). Travel receipts have steadily increased from around one per cent of GDP in the early 1990s to just short of three per cent of GDP in 2015 (Uganda Bureau of Statistics 2016). Visitor exports represent 26 per cent of total exports in 2015 (Uganda Bureau of Statistics 2016). However, since the early 2000s, computer, communications and other services have also increased their share of services exports.

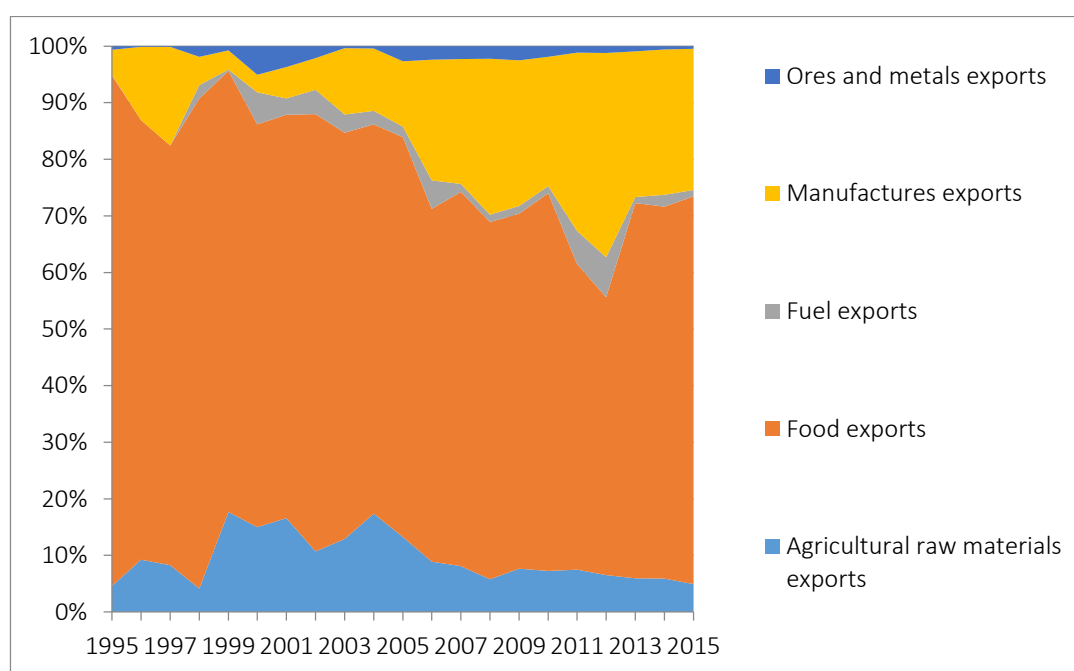
Figure 3.16. Evolution of and composition of Uganda's services exports (1995-2015)



Source: World Development Indicators (2017)

Turning to merchandise exports, Uganda has witnessed some degree of diversification over time. Figure 3.17 indicates how the share of manufacturing exports in merchandise exports has increased in recent years.

Figure 3.17. Evolution of composition of Uganda's merchandise exports (1995-2015)



Source: World Development Indicators (2017)

However, while the share of primary commodities (food, fuel and agricultural raw materials exports) in merchandise exports for Uganda has dropped from over 90 per cent for the period pre-2000, to just under 70 per cent for 2015, the share continues to demonstrate the persistence of commodity dependence in the country's merchandise exports (UNCTAD 2016: 22) and over half of manufacturing exports are made up of cement and bovine and leather goods, hides or skins. Such a continued dependence on primary commodities exposes the economy to vulnerability in commodity price volatility and indicates the country's failure to develop sufficiently export sectors that promote learning by doing and allow for increasing

returns to be reaped (most notably in the manufacturing sector) (UNCTAD 2016: 20). Uganda has indeed suffered falling prices for its main agricultural exports, including coffee, cotton and tea. In 2015, coffee accounted for 15 per cent of merchandise exports,¹⁰ followed by fish at 4.4 per cent, base metals at 4.5 per cent, cement at three per cent, tobacco at 2.7 per cent, tea at 2.6 per cent and cut flowers at 1.9 per cent of merchandise exports.

There is therefore an urgent need “to increase the sophistication of the country’s export bundle, seeking to increase the value addition processes on locally sourced primary commodities”. For Hausmann et al. (2014: 20): “Uganda has taken some steps to diversify its exports ... However, the bulk of this diversification has been into other peripheral primary products, particularly fresh fish. That being said, some non- traditional industries, such as cut flowers, plastics and metal products are also increasing their exports, albeit from a low base”. Such a finding is supported by (Shepherd 2016) who concludes that the recent trend for Uganda’s export sophistication is not promising, showing signs of instability compared with regional neighbours.¹¹ He also finds few firms engaged in high-growth, high-productivity agro-processing activities with Uganda still heavily reliant on resource-based exports. Furthermore, while regional trade between Uganda and neighbouring countries has remained stable over time, Uganda’s exports to neighbouring countries are dominated by agricultural products, predominantly food. Finally, severe supply constraints have affected major export commodities, where Uganda has failed to capture existing (and expanding) world markets (see Table 1 of (Republic of Uganda 2016)).

¹⁰ Note that Uganda is ranked as the 8th largest coffee exporter contributing to about 2 per cent of the world’s total coffee exports by volume. A large share of the coffee is exported to re-exporting countries.

¹¹ The measure of export sophistication used by Shepherd (2016) is the EXPY indicator developed by (2007) which captures the productivity level associated with a country’s export bundle.

4. Ugandan government policy in support of gainful employment?

The sections above have highlighted how the Ugandan economy has remained constrained by a fragmented structure of low-productivity activities and has failed to generate decent jobs for a fast-growing labour force. This reality has been exacerbated by a fast GDP growth deceleration over the last decade. It has also implied the persistence of widespread informalities characterising the world of work. Section 4 examines the way in which the Ugandan government has sought to address some of the challenges raised by the lack of structural transformation. It focuses, in particular, on the nature of the macro-financial environment. It is our contention that efforts to promote (decent) employment creation have remained fundamentally hampered by the government's preference for market-led private sector mechanisms to foster growth and transformation with insufficient attention to the pervasive and large-scale market failures that characterise the economy in Uganda.

The section proceeds as follows. Section 4.1 describes the broad strategic direction that the Ugandan government has sought to project over the last decade and situates this (briefly) within the broader debates on catch-up development. Section 4.2 unpacks the way in which the macro-policy landscape has been defined. This draws attention to the role of the financial sector in the Ugandan economy, with particular implications for the macroeconomic environment within which resources for investment (and hence productive employment), including through credit extension, can be mobilised.

4.1 From one National Development Plan to the other: signalling intentions for change

Over the last decade, the Government of Uganda has sought to orient policy towards job creation and the upscaling of productive capacity. This was emblematic in the adoption of the Uganda Vision 2040, approved by Cabinet in 2007. Vision 2040 has the overarching aim to transform Uganda from a “peasant and low income country to a competitive and upper middle income country within 30 years”. It signals a move away from the emphasis on social sectors and poverty reduction that had driven the Poverty Eradication Action Plan (PEAP) process and which had lacked a sufficiently explicit concern for employment, growth and structural transformation.

The National Development Plan I (NDPI) launched in 2010 was the first in a series of six development plans to implement Vision 2040. Apart from seeking to rebalance policy so as to incorporate longer-term issues related to productive capacity and employment, NDPI also sought to draw out and harness inter-sectoral linkages, functional relationships and synergies among economic sectors which had received insufficient attention in the past (Government of Uganda 2010: 6). A strong emphasis on infrastructure (power, road and rail) prevailed and job creation was a central theme of the NDPI (see Van Waeyenberge and Bargawi 2010).

The second NDP (NDPII) (Government of Uganda 2015) takes the emphasis on job creation forward. It prioritises investment in five areas that it perceives to have the greatest multiplier effect on the economy. These include: agriculture, tourism, minerals/oil and gas, infrastructure and human capital development. These priority areas are accompanied by a

set of explicit employment targets across the main sectors of the economy (see Government of Uganda 2015 Table 5.13).¹²

Like the NDPI, NDPII is committed to a "quasi-market" private sector-led approach to development. The private sector remains understood as the engine of growth to lead successfully in economic upgrading and increased value-capture processes of various kinds. The role of the government remains predominantly one of providing a "conducive policy, regulatory and institutional framework" (Government of Uganda 2010: 43). The NDP II puts this as follows (Government of Uganda 2015: 103):

A quasi-market approach will be pursued in order to increase efficiency of the public sector and competitiveness of the private sector. With this approach Government will invest in key strategic infrastructure in order to remove the barriers of entry and increase private sector participation in the key growth areas. Government will create strategic partnerships with the private sector through PPPs [public private partnerships] for investment in infrastructure, human capital, minerals, oil and gas, tourism and agriculture.

So, while government policy documents concede that during the 1990s and 2000s, policy may have been too heavily guided by a market-led approach to development, the new policy orientation through the NDPs seeks to pursue a "quasi-market approach" through "a mix of government investments in strategic areas and private sector market-driven actions".

Yet, the divergence of this new approach from the previous more market-fundamentalist imperatives remains limited and is mainly reflective of broader shifts from Washington to post-Washington Consensus in development discourse.¹³ In the context of the National Agricultural Policy (Ministry of Agriculture Animal Industry and Fisheries 2013), this becomes:

The Government of Uganda is pursuing a private sector-led and market-led oriented economy. In doing this, the government shall work on constraints that hinder the private sector from increasing investment in agriculture. Government shall support existing partnerships and form new partnerships with private sector actors. Government actions shall aim to strengthen the private sector through improved public service delivery and by putting in place an enhanced regulatory environment for the agricultural sector in Uganda.

And, in the National Industrial Policy, we find the persistence of a "business friendly environment for private-sector led industrialisation", with an explicit emphasis on "the need to minimise resistance to market signals in the course of resource allocation" (Ministry of Tourism Trade and Industry 2008: 7).

It has, however, now become well-established in the literature on development that historical experiences of catch-up necessitate strong state leadership directing investment patterns in the private sector towards strategic sectors. Well-known studies of fast-growing "latecomer" economies have highlighted the broad-based nature of discretionary government intervention in support of accelerated growth through the use of manifold instruments including: trade tariffs, import substitution, export promotion, the extensive use of performance requirements on both domestic and foreign investment, credit extension by development banks, selective promotion of industries, and massive investment in skill creation, infrastructure and support to institutions (Amsden 1989; Wade 1990; Amsden

¹² In the context of agriculture, the emphasis is on increasing production and productivity along the value chain and using agro-processing as a launch pad for industrialisation (Government of Uganda 2015: xvii). For the minerals, oil and gas sector, the NDPII equally seeks to highlight the need to add value to raw materials through beneficiation and investment in an oil and gas refinery and milling (of iron ore into steel).

¹³ See (Van Waeyenberge 2006) for a critique.

2004; Chang 2004; Lall 2005; Schwartz 2010). In the context of the LDCs, UNCTAD (UNCTAD 2006: 291) draws attention to the importance of a twin strategy of investing in dynamically growing sectors while at the same time building capacity in sectors where the majority of labour is employed and of deepening linkages between the latter and former sectors. This further needs to combine with a set of macroeconomic policies in the service of structural transformation and growth. This implies that macroeconomic and financial sector policy tools are not driven predominantly by stabilisation objectives and, instead, are oriented towards maximising domestic resource mobilisation in support of productive capacity expansion and upgrading.¹⁴

In the case of Uganda, however, the policies that seek to support a shift towards higher productivity activities remain charted in terms of unleashing private sector entrepreneurial activity across scales (micro, small and medium enterprises), without sufficient appreciation of the intricate role the state is to play for the private sector to develop along such a path, including through facilitating access to credit, the imposition of performance criteria in strategic sectors, protection of production for local markets, local content policies, specific trade policies, etc. Policy-making in Uganda has been heavily steered by market-conforming imperatives. It is governed by an understanding of the role of government as predominantly regulatory, rather than seeing the state as a strategic actor in shaping the development path of the country through the deployment of a host of “unorthodox” tools that can accelerate development. Such an approach, however, remains fundamentally constrained in its ability to increase manufacturing value added as a share of GDP.

We argue that there is a persistent (and long-standing) disjuncture between the government’s policy proposals to accelerate growth and create jobs and the actual, historical, experience of capitalist development, with little sign of this disjuncture being overcome. Indeed, across different government initiatives, a contradiction recurs between, on the one hand, the government’s celebration of the private sector as the most important agent to bring about growth and structural transformation, and, on the other hand, a failure to understand (or cater for) the specific needs of the private sector. The latter feature reflects a failure to appreciate the Ugandan reality of its very weak and fragmented domestic private sector (characterised mainly by its small-scale and low productivity, see Section 3 above). Such a weak and fragmented private sector is unable to lead on the necessary investments to expand the productive base of the country.

It is our contention that this contradiction in government policy is related to a set of tensions within the Ugandan political economy. This includes, first, the way in which macroeconomic short-term stabilisation priorities have dominated longer-term imperatives of growth and structural transformation, which is itself related to the role of the financial sector and the particular relationship of the country with the International Financial Institutions. This combines, second, with, and has been exacerbated by, the ad-hoc and fragmented nature of policy initiatives targeting specific sectors. We focus here on the former issue, while the latter is further explored in Bargawi and Van Waeyenberge (2018).

The rest of this section discusses how the Ugandan economy remains fundamentally constrained by an orthodox macro-financial policy framework. This is much in contrast, for instance, with the recent policy record in Ethiopia, where an impressive growth acceleration has been underpinned by an economic strategy that emphasises public infrastructure

¹⁴ Oqubay (2015) reminds us that while state interventions to improve agricultural productivity were largely ignored by various sub-Saharan African governments and industrial policies abandoned, domestic financial sectors were opened to foreign banks and capital accounts liberalised. This has undermined the capacity of the state to mobilise resources in favour of accelerated development and raises particularly pertinent issues for the Ugandan context (see below).

investment and that has been supported by a set of heterodox macro-financial and domestic resource mobilisation policies (Moller and Wacker 2017).

4.2 The financial sector and macroeconomic policy: persistent constraints on ambitious Development Plans.

As highlighted above, the success of a country's development strategy and its creation of gainful employment depend on a country's capacity to mobilise resources and allocate these strategically in line with core investment priorities that assist in upscaling the productive base of a country. An important determinant of the success of a strategy to increase the domestic investment rate and direct it towards sectors liable to create gainful employment is the macroeconomic policy framework adopted by a country. Particular fiscal and monetary policy stances determine the scope for public interventions, including through public investments and direct ownership of productive enterprises, as well as affect private investment through the cost and quantity of credit available to the private sector, the level of aggregate demand in the economy, etc. Fiscal and monetary policies further interact with exchange rate, capital account policies as well as the organisation of the financial sector. Together these produce particular macro- economic outcomes and investment patterns across sectors (as for instance skewed towards real estate to the detriment of manufacturing or agriculture), with important consequences for the creation of gainful employment. In most general terms, the scope for increasing the domestic investment rate and its concomitant effect on the demand for labour depends on underlying interests acting both through the state and the market, the role of finance in the economy, as well as the nature of the integration of the economy globally.

Taking the issue of finance forward, the study of development has traditionally had an interest in its role "in supporting structural transformation of an economy, from dominance of low productivity to high productivity sectors, with accompanying shifts in employment, the transformation of agriculture and the development of industry and trade"(McKinley and Tyson 2014: 3). This often proceeded on the basis of a state-dominated financial sector enabling the allocation of resources strategically across the economy through directed credit, subsidised access to finance, etc. With time, this preoccupation with a strategic role for finance has become displaced by an imperative of financial sector liberalisation and capital account openness in favour of international financial integration. Nkurunziza et al.(2012: 11) comment how "[t]he liberalization of the financial system was meant to correct market distortions and create a level playing field, improve resource mobilization and achieve efficient allocation of resources across sectors".¹⁵ Further, growing financial integration internationally would allow the capital stock in developing countries to increase by making foreign savings available.

In Uganda, the financial system has been fully liberalised since the 1990s. Financial liberalisation has proceeded both through the deregulation of the domestic financial sector and its opening to foreign investment. In July 1994, the interest rate was fully liberalised. This was followed by capital account deregulation in July 1997. These measures were part

¹⁵ The underlying idea refers back to the McKinnon (1973) and Shaw (1973) seminal contributions that argued (simplistically) that an expansion of the real money stock (as a result of interest rate deregulation) will lead to investment and thus growth. In a simple restatement of Say's Law, now in the context of finance, higher interest rates resulting from financial liberalisation would stimulate saving deposits and these would in turn enable investment outlays. See Bonizzi (2016) for an overview of the manifold critiques of this theoretical proposition and an account of the way in which the literature on financial development has been "refined and enriched" over the last few decades.

of the World Bank/IMF-sponsored Structural Adjustment and Stabilisation Programmes.¹⁶ The idea was that financial deregulation would enhance competition in the financial sector and increase the range of financial instruments available to facilitate investment in productive capacity (see Nyorekwa and Odhiambo 2014). The operation of market forces in the financial sector would improve the processes of financial intermediation, mobilisation and allocation of resources to produce accelerated investment rates in productive sectors (see World Bank (2017: ix) for a recent restatement of these arguments). Bategeka and Okumu (2010: 9) sum up: “the financial sector reforms Uganda implemented were aimed at achieving efficiency in financial intermediation on the one hand and strengthening the banking sector through efficient and effective supervision by the central bank study on the other”.

A number of important bank failures, however, ensued, following the liberalisation of the financial sector (see Nyorekwa and Odhiambo 2014)). For many, these were ascribed to the inappropriate sequence of financial sector liberalisation in the absence of the necessary regulatory reform (see Abuka and Egesa 2010).¹⁷ In response, a moratorium was put on the licensing of new banks between 1999 and 2007. The moratorium was lifted in 2007 and today the Ugandan financial sector exists of 25 banks and a set of non-bank institutions (see World Bank 2017: 26).

A few comments regarding the nature of the financial sector and its implications for credit allocation within the Ugandan economy are in order. First, the three largest banks (Stanbic bank, Standard Chartered bank and Crane bank) in Uganda account for 38.8 per cent of total bank assets (in June 2016). This is down from 49.71 in June 2012 (Bank of Uganda 2016).¹⁸ And, while the concentration of the banking sector has decreased, its alleged effect in terms of increasing the extension of credit has failed to materialise.¹⁹ Figure 4.1 illustrates how the extension of credit to the private sector by banks (as a share of GDP) in Uganda remains very low and has stagnated over most of the last decade: the ratio of domestic credit to the private sector banks as a share of GDP has remained below 15 per cent and far below the average for sub-Saharan Africa.

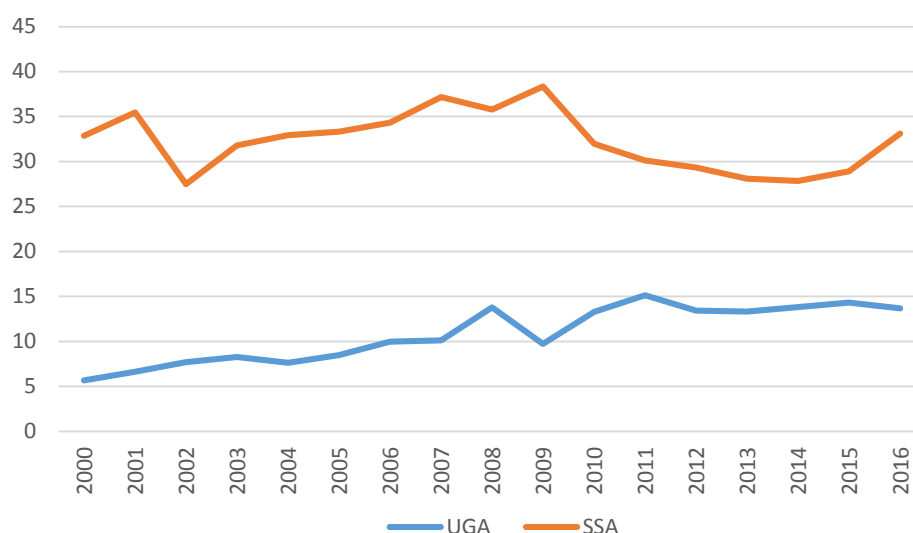
¹⁶ See Stein (Stein 2010: 266-68) for details of the financial liberalisation programme in Uganda which started with the 1993 World Bank/IDA Financial Sector Adjustment Credit.

¹⁷ This represents a general shift in World Bank-arguments of the 1990s towards an emphasis on the need for adequate sequencing and regulation in liberalisation efforts, including of the financial sector, in line with the post-Washington Consensus (see Bonizzi 2016 for a review).

¹⁸ These same institutions accounted for 37.7 per cent of total lending in 2016.

¹⁹ This is an important observation given that during various interviews we often incurred the proposition that increased competition in the banking sector would improve the conditions of credit extension in Uganda.

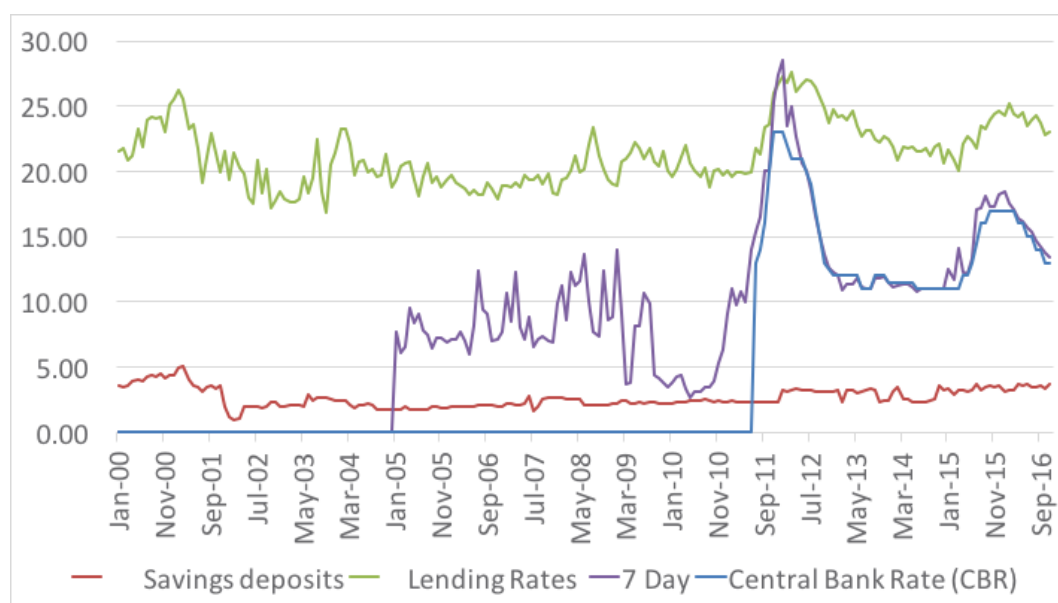
Figure 4.1. Domestic credit to private sector by banks (per cent of GDP), Uganda and SSA (2000-2016)



Source: World Development Indicators (2017)

Second, apart from a low rate of credit extension by banks to the private sector, such credit comes at a high cost. Figure 4.2 illustrates interest rates in Uganda. It documents how lending rates remain persistently in excess of 20 per cent (while deposit rates fluctuate around three per cent). And despite the Central Bank Rate (CBR) having fallen most recently (June 2017) to 10 per cent,²⁰ the (shilling) lending rate charged by commercial banks remains above 20 per cent (Bank of Uganda 2017: 10).²¹

Figure 4.2. Interest rates in Uganda



Source: UBOS, various

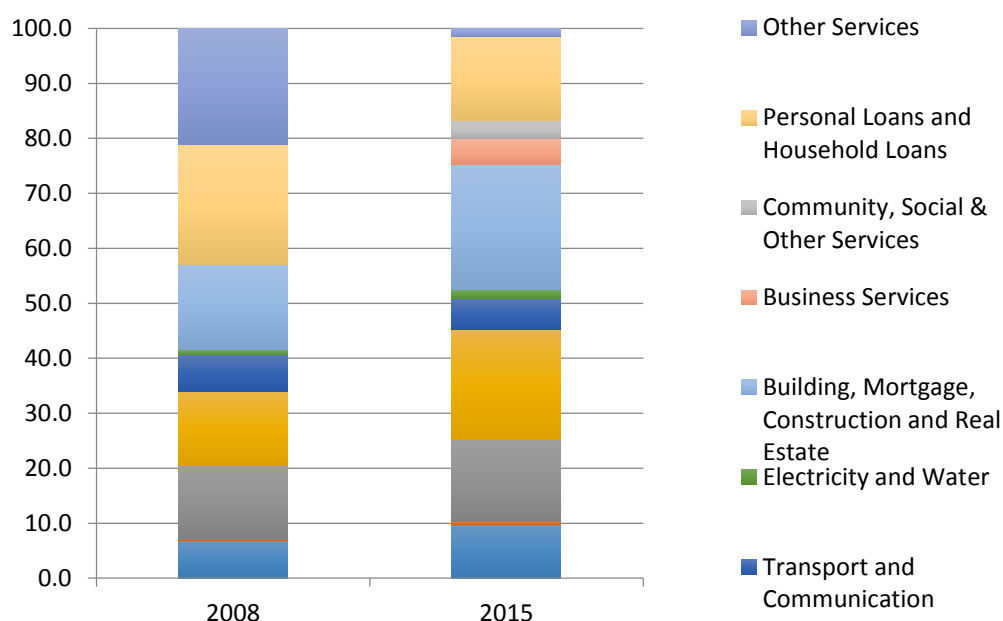
²⁰ <https://www.bou.or.ug/bou/media/statements/archive/CBR-of-August-2017.html>

²¹ See Montiel(2013)on how the structural features of Uganda's banking sector (its lack of competitiveness, its small size, its ownership structure, etc.) weaken the monetary transmission mechanism that policy rate (CBR) manipulations in support of inflation targeting rely on, see also below.

Interviews and participatory workshops conducted for the EDA repeatedly highlighted the limited access to and high cost of credit as a very important constraint on economic activity in Uganda (see Bargawi and Van Waeyenberge 2018). World Bank (World Bank 2017: 33) refers to a number of business surveys that have identified credit conditions as the most significant constraint experienced by the business sector.²² It indicates that the share of firms with a bank loan (or credit line) is less than 10 per cent (compared to an average of just under 25 per cent for SSA). The share of investments by firms that are financed by banks only amounts to just over three per cent (compared to 10 per cent for SSA), while the share of working capital financed by banks amounts to 7 per cent (compared to 10 per cent for SSA) (World Bank 2017: Table 5) .

Third, credit allocations across the various sectors do not reflect the priorities for investment and employment creation bearing on the Ugandan economy. Despite marginal increases in lending to the manufacturing sector between 2008 and 2015 this still represents just 15 per cent of total private sector lending (having increased from 13.2 per cent in 2008). Similarly, agriculture's share has increased from 6.9 per cent in 2008 to 9.8 per cent in 2015. However, the trade and the building, mortgage, construction and real estate sectors together with loans to the household sector lead in the distribution of credit to the detriment of lending for agriculture and manufacturing (see Figure 4.3 below).²³

Figure 4.3. Sectoral Shares of Credit Extended to the Private Sector (per cent of total)



Source: Uganda Bureau of Statistics (2016)

Griffith-Jones and Karwowski (2013) emphasise that the much-vaunted relationship between financial sector development and growth crucially depends on whether financial sector deepening enables the financing of investment in productive assets through the extension of enterprise credit (rather than for instance feeding speculative bubbles through over-extension in real estate). The literature on financial sector development has also shown

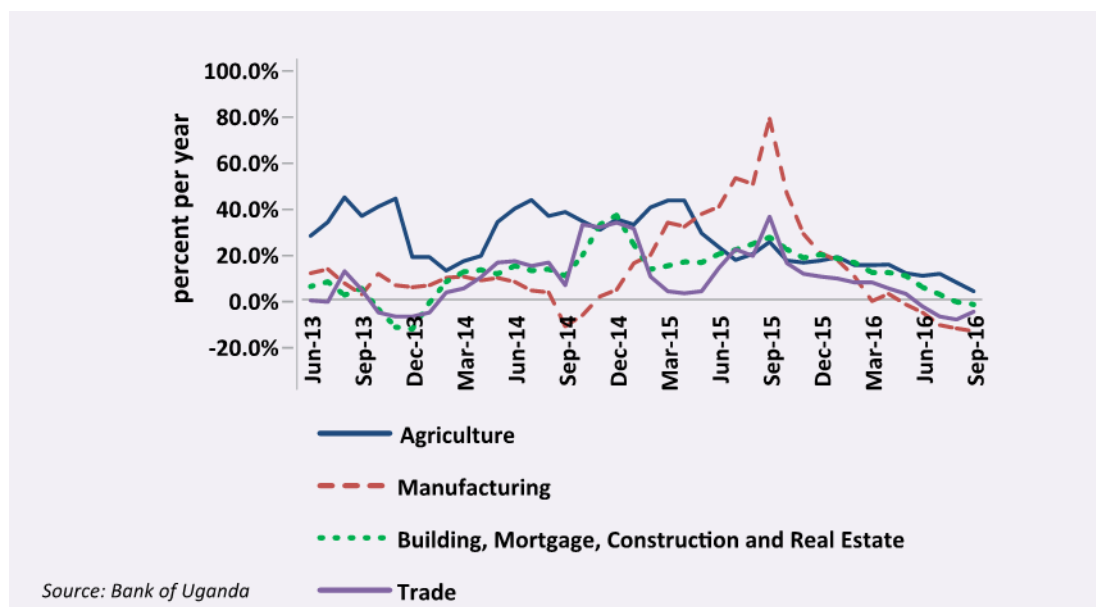
²² World Bank (2017) reports that according to the Economic Forum Global Competitiveness Report (2016- 2017), in terms of the affordability of financial services index, Uganda ranks 120 out of 138 countries, with a steady decline in its position over recent years.

²³ World Bank (2017: 35) adds that the bulk of agricultural credit is allocated to large-scale farmers. This implies that small- scale farmers, who collectively constitute more than 90 per cent of the agricultural system, have limited access to credit.

that while there is a positive relationship between credit to firms and growth, there is no correlation between growth and household credit (see Beck, Demirgüç-Kunt et al. 2011). Furthermore, rapidly growing credit to households may cause instability, in the absence of adequate prudential regulation and supervision.

Fourth, credit conditions in the Uganda economy have worsened remarkably since mid-2015. This is reflected in Figure 4.4 below which highlights the deceleration of the year on year growth of credit allocated to different sectors between mid-2015 and end of 2016 (and illustrated in the downturn in private sector credit extended by the banks as share of GDP in Figure 4.1 above). It bears repeating that this is despite the relative loosening of tight monetary policy conditions (see above).

Figure 4.4. Year-on-year growth in credit allocation across sectors



Source: World Bank (2017:8)

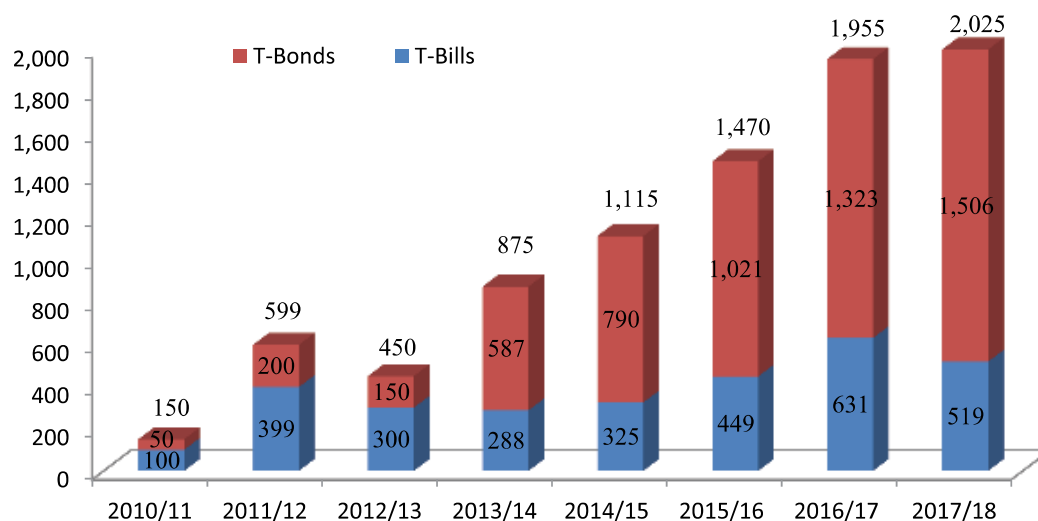
Fifth, the above picture of costly and inadequate credit extension by banks to the private sector needs to be complemented with the observation that the Ugandan banking sector has held a significant share of its assets in the form of government securities. These represent on average around 20 per cent of bank assets which is a higher proportion than in neighbouring countries like Rwanda, Burundi and Tanzania (World Bank 2017).²⁴ This compares to a share of gross loans in total assets of just over 40 per cent (June 2016, see Bank of Uganda (2017: Table 3). While such a portfolio does not necessarily imply inefficiencies in credit allocations if government borrowing is deployed to finance investments with high social returns, such an outcome depends, on the one hand, on whether government securities support fiscal rather than monetary operations and, on the other, if the securities support fiscal operations, on the nature of these fiscal operations. Furthermore, interest payments to the financial sector raise distributional issues as interest payments have rapidly increased in the national budget over the last few years (see Figure 4.5).²⁵ For the last two years, interest rates (on both domestic and foreign debt) have taken up in excess of 10 per cent of total

²⁴ During the year to June 2016, further, banks increased their holdings of government securities by 15.9 per cent up from 6.1 per cent while lending grew by 3.7 per cent compared to 19.7 per cent, reflecting a shift from riskier assets to safer assets (Bank of Uganda 2016: 16).

²⁵ This is perhaps even more significant when the tax base is mobilised to pay large amounts of interest payments to foreign banks (see below).

government expenditure, with the bulk of this accounted for by interest payments on domestic debt (see Government of Uganda 2017 Table 4.8).²⁶

Figure 4.5. Domestic interest rate payments in current UGX Billion



Source: Government of Uganda (2017: 42).

Finally, the banking sector has suffered from a dramatic increase in non-performing loans over the last few years. Between June 2015 and June 2016, the share of non-performing loans (NPLs) in total loans increased from 4 to 8.3 per cent (Bank of Uganda 2016). The EDA data collection period (November 2016–April 2017, see Bargawi and Van Waeyenberge 2018) took place as another domestic banking crisis unfolded with the Bank of Uganda’s take-over of Crane Bank (on 20th of October 2016). Crane had been Uganda’s fastest growing commercial bank and had won the “bank of the year” award for 10 times in its 20-year existence (MUBS Economic Forum November 2016). The Bank of Uganda takeover was motivated by the systemic risk Crane Bank presented to the Ugandan financial system as Crane was one of the systemically important institutions of the Ugandan banking system with 46 branches and almost 500,000 accounts (World Bank 2017: 22). Its ratio of NPLs to total loans had reached 23 per cent prior to its takeover. This latest intervention by the Bank of Uganda follows a series of recent commercial bank closures (National Bank of Commerce in 2012, the Global Trust Bank Uganda Limited in 2014, Imperial Bank in 2015).²⁷

²⁶ The exact shares are as follows: for 2015/17, interest payments accounted for 10 per cent of total expenditure (and 8.7 per cent of total expenditure was for interest payments on domestic debt); for 2016/17, interest payments accounted for 13.6 per cent of total government expenditure (and 11.3 per cent of total expenditure was for interest payments on domestic debt). Note that we refer to “domestic debt” on the basis of the currency denomination of the debt. This does not, however, give indications of ownership of the debt (foreign versus domestic). Further, in light of the stark increase in interest rate payments, Government of Uganda (2017: 41) indicates that the government will seek to reduce its borrowing from the domestic market to reduce interest rate costs.

²⁷ The takeover of failing banks by the Bank of Uganda needs to be situated in the context of successive recapitalisations of the Bank of Uganda (in 2012/13 for UGX 410 billion, in 2014/15 for UGX 150 billion, and in 2016/17 for a projected UGX 100 billion). The original request for the 2014/15 recapitalisation had been for UGX 200 billion but this failed to be approved by Parliament, which approved UGX 150 billion instead. It was argued that “the request to capitalize Bank of Uganda comes at a time when then Country is faced with numerous unfunded and underfunded priorities amidst a constrained resource envelope and the justification for this proposed recapitalization was wanting” (Parliament of Uganda 2015: 83).

In January 2017 Crane Bank was sold to DFCU Bank Ltd, a foreign-owned concern with leading shareholders including Rabobank, the Commonwealth Development Corporation and Norfinance. The Global Trust Bank had equally been sold to DFCU in 2014 and the assets of the National Bank of Commerce had been taken over by Crane Bank and had with the latest sale equally come under the control of DFCU. With the sale of Crane Bank to DFCU, the entire banking sector of Uganda became foreign-owned, with the exception of the Centenary Rural Development Bank, the Finance Trust Bank and the Housing Finance Bank. This sequence of events and its particular outcome in terms of foreign ownership are, however, not exceptional. Indeed, Stein (Stein 2010 260) observes how:

The rapid foreign takeover of banking assets where the World Bank and the IMF dominated policy formation is no coincidence. In many countries the World Bank- and IMF-sponsored financial liberalisation had emphasised privatisation to domestic banks and led to financial crises. Following these crises banks were either sold off to foreign owners or new licenses were issued to foreign banks.

Despite traditional arguments promoted by the World Bank (see e.g. Clarke, Cull et al. 2001) that foreign bank entry improves financing conditions (of both quantity and terms), even if with a bias for larger enterprises, Dos Santos (2011: 200) observes how “foreign banks [have] proved to lend less to small and medium enterprises than domestic banks”. Stein (Stein 2010: 265) points to evidence that “the growing presence of foreign banks was overwhelmingly associated with lower overall growth and share of lending to the smaller businesses”. At the same time, foreign banks tend to lead the way “in a boom of lending to households for consumption and mortgages”. Dos Santos (2011: 200) adds that IMF’s (2006) Global Financial Stability Report had already explicitly noted “that the rapid growth in credit to households in developing countries significantly followed from the increased presence of retail-lending-oriented foreign banks, which operate with ‘well-developed consumer-lending strategies’ (pp. 46–8)”. Such orientations are to the detriment of credit for productive investment and strongly characterise Ugandan credit extension, as was documented above.²⁸

Foreign banks also tend to rely on cross-border borrowing for funding their activities which leads them to promote foreign-currency denominated loans. The increased prevalence of foreign-currency denominated loans in credit extension in Uganda has indeed worsened financial vulnerabilities with an accumulation of currency risk by often unhedged borrowers.²⁹ Reflecting these general trends, an important aspect of the credit risk implied in the rising share of NPLs referred to above has been the rising exposure of commercial banks to the real estate sector, which accounted for 25 per cent of total loans in 2016 (Bank of Uganda 2016: 34). This includes the risk that ensued from the increased practice by commercial banks to encourage their clients to contract foreign currency denominated real estate loans especially for commercial real estate and land purchases. This allegedly was to hedge against rising interest rates on shilling loans, but clearly increased the likelihood of

²⁸ Stein (2010: 267) refers to a World Bank study which highlighted that following the sale of the Ugandan Commercial Bank to Stanbic (a South-African bank), credit growth slowed, the share of lending to manufacturing collapsed and holdings of government securities rapidly increased to 50 per cent of total assets.

²⁹ Foreign currency denominated assets in Uganda have seen an upward trend as a share of total assets, and in June 2016 accounted for 35 per cent, the highest such share for the EAC (compared to 16.4 per cent for Kenya, 32 per cent for Tanzania, 16.8 per cent for Rwanda, and 14.5 per cent for Burundi) (Bank of Uganda 2016: 40 Table 1).

default risk in the event of exchange rate depreciation (ibid.).³⁰ Capturing these trends across different countries, Stein (Stein 2010: 256-6) sums up as follows:

in a world of open capital accounts foreign banks have little appetite for the risks of developing countries. Instead, entry into developing countries becomes part of a global strategy of private maximisation, which is rather an anathema to the development process. Beyond servicing government debt needs, large frequently resource based multinationals and wealthy local elite, multinational banks are interested in moving funds out of developing countries as part of their global strategies of profit maximisation and accumulation. In this world small depositors and local SMEs in developing countries are mere nuisances of little consequence to these strategies. In this regard, the World Bank and IMF have been instrumental in increasing multinational bank access to developing country markets while demobilising the mechanisms of constraint at the national level that might impede their global accumulation strategies.

Bategeka and Okumu (2010: 39) transpose this for the specific context of Uganda:

liberalization of the banking sector in Uganda has led to limited competition in the sector. Commercial bank lending interest rates have remained persistently high ... the drive for soundness of the banking sector in Uganda has been achieved at the cost of surrendering the key tenets for which liberalization of the banking sector was fronted i.e. competition and reduced investment costs. Access to financial services especially in rural areas remains a daunting challenge, with microfinance institutions offering financial services that not only hardly meet the needs of the rural dwellers, but also at very high cost in terms of high nominal interest rates and other transaction costs.

In sum, despite being celebrated by the International Financial Institutions as the main vehicle through which credit will be extended in the service of the structural transformation of the country(see International Monetary Fund 2017; World Bank 2017 for recent statements), the Ugandan financial sector remains characterised by a set of fundamental weaknesses. Oqubay's (2015: 56) argument that the abandonment by many African countries of industrial policies in combination with the opening of their financial markets has weakened domestic capital's capacity to expand the productive base across African economies (see above), rings particularly true for the Ugandan case.

While the Ugandan financial sector is fully liberalised and closely integrated internationally (its banks are now almost entirely foreign-owned), it is extending insufficient credit at too high a cost. Its lending portfolio is skewed away from the sectors necessitating credit to finance investment for the rapid expansion of gainful employment. As such, the financial sector is failing to perform the role that is commonly ascribed it.³¹ Financial sector liberalisation has not produced private investment in productive capacity to the extent that is needed for the Ugandan economy to absorb its fast-growing labour force into productive employment. High cost of credit prevails combined with a skewed allocation of credit away from sectors that need to access to credit both to finance working capital and to increase productive capacity.

³⁰ The 2016 Financial Stability Report (Bank of Uganda 2016: 35) observes that: "anecdotal information obtained by BOU indicated that some commercial banks had encouraged their clients to contract foreign currency denominated real estate loans especially for commercial real estate and land purchase, to hedge against rising interest rates on shilling loans. This increases the likelihood of default risk in the event of exchange rate depreciation".

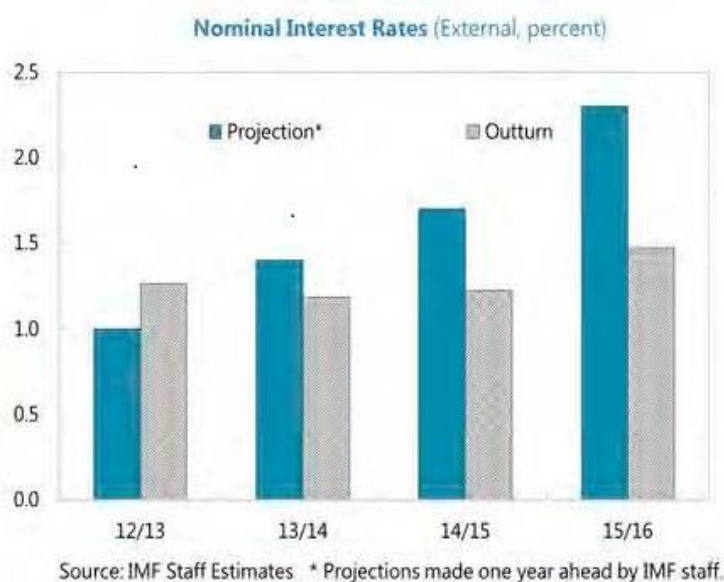
³¹ Note that initiatives that foster financial inclusion, such as for instance through the National Financial Inclusion Strategy, are unlikely to overcome the structural deficiencies emanating from the financial sector, including in its biased allocation of credit towards sectors that are unlikely to generate fast accelerations in productive employment as well as in the high cost of its credit extension.

The orthodox policy framework that promotes financial sector liberalisation has been accompanied by particular macro-imperatives. These macro-imperatives have interacted negatively with the particular features of the financial sector laid out above. Indeed, macroeconomic policy has been overwhelmingly geared towards macroeconomic stability which has been narrowly understood in terms of price stability (through inflation targeting). Concretely, the agenda of macroeconomic stability translates into the following specific imperatives:

1. To achieve and maintain a real rate of growth of at least 6 per cent per annum.
2. To maintain annual core inflation “close to BOU’s 5 per cent target and annual headline inflation within single digits”.
3. Monetary and economic convergence and compatibility within the EAC
(Ministry of Finance Planning and Economic Development 2016: 6).³²

Fiscal priorities have been enshrined in the Public Finance Management Act (2015) which instituted a Charter of Fiscal Responsibilities to govern the reporting requirements of the Government to Parliament. Through the Charter of Fiscal Responsibilities, the Government pledges to two measurable objectives for fiscal responsibility: 1) the government’s fiscal deficit (including grants) to be no greater than three per cent by 2020/21; and 2) public debt to remain below 50 per cent of GDP (with the net present value of external debt to be maintained below 30 per cent and the net present value of domestic debt to remain below 20 per cent) (MOFPED 2016: 6). The economic logic inspiring the three per cent limit on the deficit remains elusive while the consequent trends towards fiscal consolidation has significant (negative) implications for the fiscal space of the government. These have been particularly strong for the public investment programme that the government has embarked upon since NDPI. Indeed, public investment levels remain low (see Section 3) and the budget for public investment over the last few years has systematically been larger than the actual outturn (see Figure 4.6).

Figure 4.6. Development spending (as share of GDP), budget (planned) versus outturn (executed)

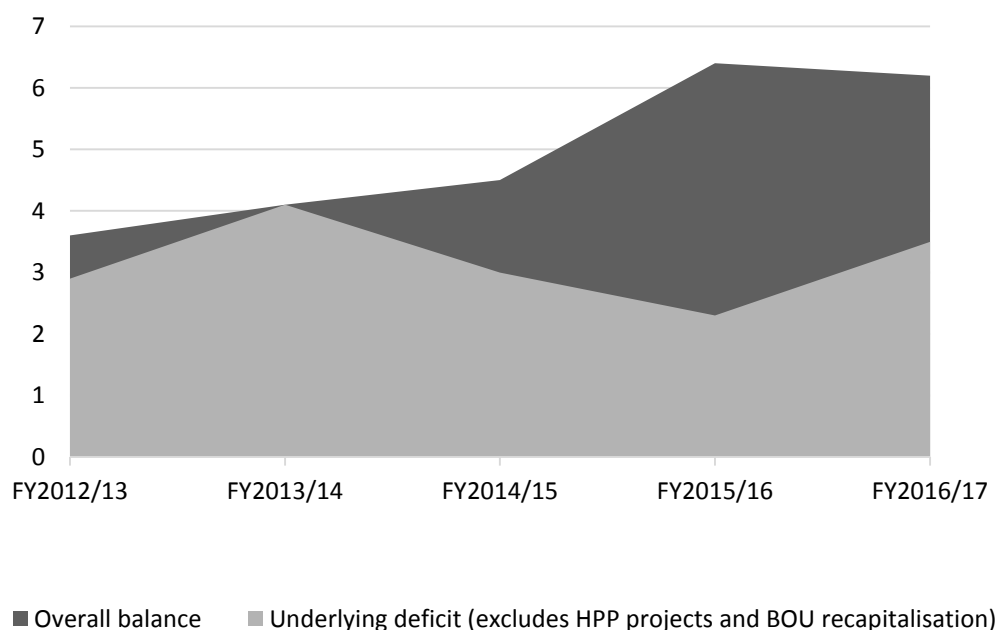


Source: IMF (2017: 33)

³² The EAC convergence criteria for monetary and fiscal policy targets are as follows: 1) a ceiling on headline inflation of eight per cent; 2) a ceiling on fiscal deficit (including grants) of 3 per cent of GDP; 3) a ceiling on gross public debt of 50 per cent in net present value terms; 4) reserves cover of 4.5 months of imports (Ministry of Finance Planning and Economic Development 2016)

While the discrepancy between the budgeted and actual capital expenditure may reflect difficulties in executing the public investment programme, it equally captures a reluctance to incur fiscal deficits beyond the limits adopted through the EAC criteria. Figure 4.7 below illustrates recent trends in the fiscal deficit. This indicates that the recent increase in the deficit is entirely driven by the recapitalization of the BOU and the Hydropower projects (Karuma and Isimba), with the latter financed through external debt. Beyond that, the trend to consolidate the fiscal deficit below three per cent is strong and acts as a constraint on the mobilisation of resources for public investment.

Figure 4.7. Fiscal deficit (as share of GDP), FY2012/13 – FY2016/17



Source: IMP (2017)

Van Waeyenberge and Bargawi (2010) undertake a comprehensive assessment of the implications of Uganda’s macro-economic policies for the scope to increase opportunities for decent work. We argue that tight monetary and fiscal policies, a flexible exchange rate, an open capital account, combined with extensive deregulation and privatisation efforts have hampered improvements in labour market outcomes as they have limited the scope to increase productive employment. We, further, assert that while the NDPI signified a welcome re-orientation towards policy issues of a longer-term nature and projected an ambitious reorientation of the country’s development strategy (with significant implications for job creation), closer inspection of the Plan and its interactions with the government’s Medium Term Expenditure Framework revealed the constraints imposed by the latter. In effect, budgetary projections through successive National Budget Frameworks persistently fell short of fiscal projections for the NDPI (see Van Waeyenberge and Bargawi 2010).³³

The macroeconomic strategy for the NDPII, in turn, has remained “underpinned by the objective of maintaining macro-economic stability”, while it seeks at the same time to mobilise resources needed to address the various infrastructural priorities identified in the

³³ For 2014/2015 for instance, the projected budget was 17 per cent below the NDP projection (MOFPED 2014: 6).

NDPII (Government of Uganda 2015b: xxiv). As such, it seeks to combine macro-economic stability with the necessary fiscal expansion for infrastructure investments. The imperative of macro-economic stability, however dominates the need to increase public investment. This is nicely captured in the following extract from the Second Development Plan

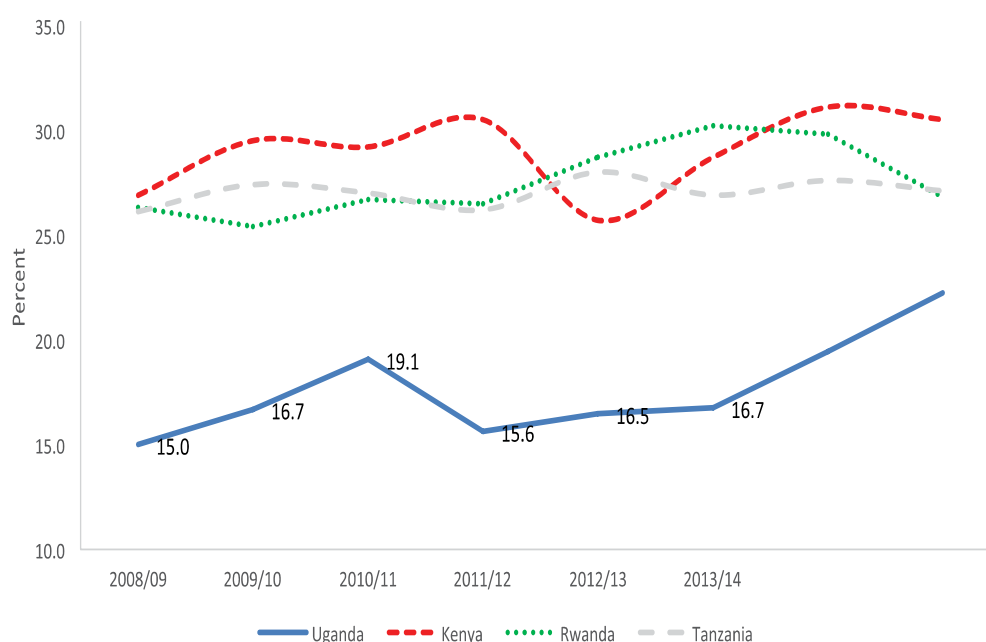
(Government of Uganda 2015: 103):

To realise the necessary public investment, government will harness concessional and semi-concessional financing and other development support facilities that are targeted to accelerate investment in infrastructure and human development, among other. However, government will be mindful of the need to maintain macroeconomic stability.

Yet, it has probably been overstated in the literature that “(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” (UNRISD 2010: 1).

In the Ugandan context, while efforts have been made to increase resources available for public investment, this remains insufficient. Figure 4.8 compares total public expenditures as a share of GDP across the neighbouring countries and highlights that while public expenditure has increased recently in Uganda, it remains well below regional expenditure patterns. Moreover, public investment rates (as share of GDP), after a temporary increase, are projected to remain low hovering around six per cent of GDP over the period of the NDPII (2015/16–2019/20) (see Government of Uganda 2015: Table 5.1).

Figure 4.8. Public expenditures as share of GDP (Uganda, Kenya, Rwanda, Tanzania)



Source: World Bank (2016: 27)

The tendency towards fiscal consolidation reflects the imperative of inflation control as the main expression of the search for macro-economic stability. This is despite inflation

in Uganda having remained within single-digits over a sustained period of time.³⁴ Furthermore, such a stance reflects an erroneous understanding of the relationship, on the one hand, between a fiscal deficit and inflation,³⁵ and on the other, inflation and growth. With regard to the latter, across a contested academic and policy literature, no consensus exists on what “safe” inflation thresholds are in developing countries. Following Ortiz et al.’s (2017) summary of a wide spectrum of views across academic and IMF contributions on what constitutes an “acceptable level of inflation”, its value varies between 3 and 40 per cent (see Table 4.1) Ortiz et al. (2017: 51) conclude that: “inflation thresholds are arbitrary policy choices based on particular conditions in different societies, and monetary policies should be designed to encourage employment creation”.

Table 4.1. Results of survey of literature on “safe” inflation thresholds for developing countries

	Author(s)	Inflation threshold (%)
Academic papers	Fischer (1993)	15-30
	Bruno (1995)	20
	Barro (1996)	10–20
	Bruno and Easterly (1998)	40
	Gylfason and Herbertsson (2001)	10-20
	Rousseau and Watchel (2002)	13-25
	Burdekin et al. (2004)	3
	Gillman et al. (2004)	10
	Sepehri and Moshiri (2004)	5-15
	Pollin and Zhu (2006)	14-16
	Li (2006)	14
	Vaona and Schiavo (2007)	12
	US GAO (2009)	5-12
	Bick (2010)	12
	Kremer et al. (2011)	17
IMF papers	Sarel (1996)	8
	Ghosh and Phillips (1998)	>5
	Kochar and Coorey (1999)	5
	Khan and Senhadji (2001)	11-12
	Selassie et al. (2006)	5
	Espinoza et al. (2010)	10
	Blanchard et al. (2010)	4

Source: Ortiz et al. (2017: 50)

³⁴ The exceptions are short episodes (in 2008 and 2011) when inflation increases were mainly driven by increases in food and fuel prices.

³⁵ Van Waeyenberge and Bargawi (2010: 31) dispel this myth with reference to (2010: 15): “Uganda is unlikely to register higher inflation just because of a wider fiscal deficit, mainly for the following two reasons: 1) 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 ... 2) The Ugandan economy is operating at below full employment, calling for a stimulus package to increase resource allocation and utilisation, employment and capacity utilisation”.

Nevertheless, in Uganda, a strict inflation-targeting regime has taken prevalence over fiscal needs (with significant repercussions for the fiscal resources available to finance public investment). Ndikumana (2017) provides a recent account for sub-Saharan Africa of the costs in terms of reduced investment that result from the pursuit of inflation control through monetary policy. Econometric evidence drawing on a sample of 37 sub-Saharan African countries over the period 1980-2012 demonstrates how “contractionary monetary policy affects domestic investment negatively both indirectly through the bank lending or quantity channel as well as directly through the interest rate or cost of capital channel” (p. 1). Referring to the observations regarding the financial sector above, Ndikumana (2017) highlights that:

In the case of SSA countries, policies that seek to restrict domestic credit as a means of containing domestic demand and inflation ultimately exacerbate the negative effects of the already pervasive credit rationing by banks. Lack of competition in African banking systems keeps borrowing costs high. In addition, banks tend to lend to sectors that are deemed safe, notably large trading companies. Banks have little incentives to expand their customer base as long as they are able to maintain high profit rates while minimizing exposure to risk.

Credit contractions have significant effects on the supply side of the economy as they negatively affect the ability of firms to invest and hire labour. As such, “credit contraction causes a decline in capacity utilization, employment, and production. Tight monetary policy, which is usually associated with high interest rates and a strong currency, particularly hurts export-oriented sectors by undermining international competitiveness” (p. 5).

In sum, the discussion in this section has sought to draw out some tensions and contradictions that underlie the Ugandan government’s reliance on the private sector to spearhead a rapid upscaling of productive capacity. It highlighted the inadequacies of a strategy that relies on the private banking sector to finance investments against the backdrop of an orthodox macroeconomic policy stance which circumscribes the capacity of the state to engage in large-scale investment programmes. Bargawi and Van Waeyenberge (2018) further document how the realities bearing on the scope to finance development have negatively combined with the fragmented and ad-hoc character of policy-making. In general, the combination of a market-led paradigm with an orthodox macro framework produces a set of negative micro-realities in terms of how government expenditures are allocated within a particular resource envelope, including in terms of the specific activity funded, the particular actors favoured and the general conditions under which interventions take place. These include the demand-led nature of agricultural interventions, the absence of performance criteria in industrial policy, the absence of a strategic directive framework with regard to FDI, the absence of tariffs to support export promotion, etc.

5. Policy Recommendations

Policies aimed at supporting “decent work for all” in Uganda need to look beyond the labour market and to address the nature and potential deficiencies of growth and structural change in the economy. This requires close consideration of how and why structural impediments persist, including a rethinking of Uganda’s macroeconomic framework and for the latter to place structural transformation and the associated employment challenge at its centre.

Van Waeyenberge and Bargawi (2010) emphasise that the macro-framework determines (and constrains) the scope for large upscaling in an economy. To bring about a growth path that generates fast accelerations in productive employment, a macroeconomic policy stance is necessary that puts public investment at its centre and this needs to be accompanied by focused sectoral policies that seek to ensure that increased investment translates into changes in patterns of employment towards higher productivity activities and labour market policies that support decent work and pay. In essence, this involves a more strategic deployment of macro-economic policy in support of growth, structural transformation and the creation of gainful employment and for this to be accompanied by a broader set of interventions, including to support labour market institutions, such as the introduction of a minimum wage, fostering basic and vocational skills and training opportunities, and the development and implementation of a comprehensive industrial policy.

In relation to fiscal policy, there is an urgent need to rethink the conservative approach to public investment. The Ugandan economy is operating below capacity with ample scope to increase public spending, particularly in areas that would crowd-in further private investment. This includes both physical infrastructure investments but also much needed investments in social infrastructure, including through increased spending on health and education that would create much-needed skilled employment for both men and women. 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.

The acceleration of public spending needs to be complemented with improved efforts to mobilise domestic revenue. Ortiz et al. (2017) suggest a broader spectrum of ways in which fiscal space can be fostered. This has become all the more urgent in Uganda as overseas development assistance flows from traditional donors have stalled since the Global Financial Crisis. Mawejje and Munyambonera (2017) outline a number of ways in which (domestic and external) resource mobilisation can be improved for Uganda, including curtailing capital flight and leveraging non-tax revenue contributions. Turning to new and emerging donors, including China, India, South Korea and Turkey may also offer further opportunities to raise new sources of external finance.

With regard to monetary policy, there is an urgent need to rethink its role beyond inflation-targeting. Epstein (2013: 283) calls for “developmental central banking” that “can enhance coordination with broader governmental macroeconomic and developmental policy” and goes on to highlight how various countries have successfully adopted such a strategy. In the context of Uganda’s development and job-creation objectives, as outlined in NDP II (Government of Uganda 2015), monetary policy must therefore accommodate two complementary objectives. The first is to increase overall public and private investment; and the second is to direct such investment strategically to sectors and firms that can generate much-needed jobs. These objectives could be implemented by extending subsidised credit to strategic industries and firms as well as by including job-generation clauses in loans to the private sector. Recent discussions in Uganda have focused on strengthening the role of the Uganda Development Bank (UDB) in this regard. However, it is insufficient to increase

credit extension through the UDB without a clear framework that guides such credit extension to strategic sectors and that includes performance requirements in return for access to subsidised credit. Macroeconomic policy, once again, needs to be devised in support of (rather than acting as constraint on) the broader strategic objective of structural transformation to effect much-needed increases in decent work.

6. Conclusion

This Working Paper argues that the macroeconomic policy agenda continues to restrict the scope for a fundamental transformation of the Ugandan economy necessary to support much-needed job creation and increases in the standard of living. It draws on background research conducted as part of an EDA for Uganda (see Bargawi and Van Waeyenberge 2018) and raises the following issues.

First, despite progress in relation to poverty reduction in the past, the creation of decent jobs for the rapidly expanding working-age population of Uganda remains inadequate. The labour market remains characterised by very high rates of informality, under-employment and low and stagnant wages. New and existing labour market participants work in low-productivity activities in either agriculture or services trade. Second, labour market outcomes in Uganda are strongly linked to the nature of the country's growth since the mid-1990s. Specifically, the insufficient structural transformation of the Ugandan economy has restricted the demand for decent jobs in high(er)-productivity growth sectors. Third, the Ugandan authorities' have signalled increasing awareness of the need to tackle the employment challenge, most recently through the second National Development Plan (NDP II) (Government of Uganda 2015), which recognises the urgent need for decent jobs.

However, despite such recognition, policy initiatives have suffered from major drawbacks. The focus here was on a disjuncture between the Ugandan government's policy proposals to accelerate growth and create jobs, and the actual, historical experience of capitalist development. Indeed, across different government initiatives, a contradiction recurs between, on the one hand, the government's celebration of the private sector as the most important agent to bring about growth and structural transformation, and, on the other hand, a failure to appreciate (and cater for) the specific needs of the private sector, (beyond those of the financial sector). This transpires from the way in which short-term macro-financial priorities have dominated longer-term imperatives of growth and structural transformation. This has direct effects in terms of levels and allocation of public investment. It has indirect effects on private sector investment, resulting from the inadequate availability of credit, high cost of capital, insufficient domestic demand resulting from insufficient crowding in through public investment and low productivity and hence purchasing power across the economy.

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