Report

Age of choice

Uganda in the new development finance landscape

Fiona Davies, Cathal Long, Martin Wabwire

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Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ

Tel. +44 (0) 20 7922 0300
Fax. +44 (0) 20 7922 0399
E-mail: info@odi.org.uk

www.odi.org
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Cover photo: Reuters/James Akena, 2015. A woman working in a construction site moves building material in a section of a new hospital in Hoima town, Uganda, April 27, 2015.

Key messages

- **Official development finance beyond ODA accounted for just 6.3% of total development finance to Uganda between 2002 and 2013, amounting to $1.4bn.**
- **Since 2013, there has been a step change.** In 2014-2015 the Ugandan Parliament approved $2bn of non-ODA loans, primarily from China. These made up 67% of total new external financing commitments for the year, including grants.
- **Non-ODA loans are expected to constitute 70% of new government borrowings to 2025/26, amounting to $7.4bn in value.** Borrowing from China Exim Bank is expected to account for almost 80% of non-ODA loans to 2025.
- **The government has decided not to issue sovereign bonds** for the time being, given the availability of cheaper sources of financing, including from China.
- **Politically, Chinese loans are considered preferable to public–private partnerships (PPPs)** for large-scale infrastructure investments because they are faster and deemed to deliver a lower cost for end-users.
- **Scope remains to develop PPPs for projects where there is less immediate political pressure** for visible results and/or donor support to structuring the PPP arrangements.

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1 Introduction

1.1 Background

Development finance has changed rapidly over the past 15 years. Traditional official development assistance[1] (ODA) from members of the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC) is becoming less important for a number of recipient countries. These trends have been driven by supply and demand factors.

In terms of supply, the development finance landscape has undergone what Severino and Ray (2009) have described as a 'triple revolution' – in actors, goals and tools. There are many new providers of development finance globally, including non-DAC donors, such as India and China, and philanthropic foundations, such as the Bill and Melinda Gates Foundation. There are also new goals, such as those related to climate change adaptation and mitigation, which have led to the creation of dedicated vertical funds to address these challenges at global and national levels. Finally, complex new finance instruments are increasingly being developed to leverage the involvement of the private sector in public-sector financing, as is the case with public–private partnerships (PPPs). A second factor is that fiscal austerity in OECD countries is also putting pressure on aid budgets.

On the demand side, the number of low-income countries has been shrinking in the past 10 years and graduation to the status of lower-middle-income country has clear implications for financing options. Ever more countries will be graduating away from eligibility for concessional financing from the multilateral development banks (MDBs) in the coming years. A number of bilateral development agencies review their funding strategy once an aid-recipient country reaches middle-income country status, moving from grants to loans or phasing out their assistance.

In addition, several countries in sub-Saharan Africa have obtained access to international sovereign bonds in the past 10 years, including countries that benefited from debt relief. While sovereign bonds have advantages – such as flexible use of funds, access to increased funding volumes, diversification and risk mitigation – they are far more expensive than concessional and non-concessional loans offered by OECD-DAC member countries or the MDBs.

This study is one of a set of case studies that examine the challenges and opportunities facing governments in managing this new context for development finance. It builds on and expands the framework developed in Greenhill et al. (2013), within which the cases of Cambodia, Ethiopia, Fiji, Papua New Guinea, Vanuatu and Zambia were analysed (Phase 1). Schmaljohann and Prizzon (2015) summarise the key findings.

The Uganda case study, and others conducted in Kenya, Lao People's Democratic Republic and Viet Nam (Phase 2), expand on the initial analytical framework to analyse the experiences of governments in accessing and managing development finance flows beyond ODA.[2]

The flows analysed in this case study are:

- Concessional financing from bilateral OECD-DAC donors and multilateral development institutions which qualifies as ODA (see Box 1)
- Other officials flows (OOFs) from bilateral OECD-DAC donors and multilateral development institutions, i.e. official transfers that do not qualify as ODA because they fail to meet the ODA concessionality criteria and/or do not have a development focus
- Flows from bilateral non-DAC donors, both concessional and non-concessional
- Flows from philanthropic foundations
- Climate finance (multilateral[3])
- International sovereign bonds
- PPPs – an instrument of financing, rather than a source, but they provide a concrete example of how governments, aid agencies and the private sector can work together.

This study refers to 'traditional' donor financing as ODA provided by OECD-DAC members and multilateral development institutions. 'Non-traditional' donor financing

1 ODA is broadly defined as flows that have a development focus and have a grant element of at least 25% when calculated against a commercial interest reference rate of 10% – see Box 1 for further details.

2 These flows have four main characteristics: they are cross-border (excludes domestic bond markets and taxation); have a public or philanthropic motive (excludes foreign direct investment (FDI) and remittances); are not managed via traditional bilateral or multilateral aid systems (thus excluding ODA grants and concessional loans originating from OECD-DAC donors, but not multilateral public climate finance when subject to project- or programme-level competition); and are under the direct influence of government and accounted for independently from the level of concessionality, and potentially have an impact on government budgets (such as contingent liabilities, PPPs or issuances of sovereign bonds in international financial markets).

3 We looked into multilateral (not bilateral) climate finance because funding and delivery mechanisms for multilateral climate finance are based on competitive processes.

here is development finance beyond ODA. This includes: non-concessional assistance from OECD-DAC donors and multilateral development institutions; assistance from bilateral non-DAC donors, philanthropists and multilateral climate funds; and private flows from international sovereign bonds and other sources, such as PPPs.

1.2 Methodology and research questions

The methodology for the case studies is adapted from Fraser and Whitfield (2008) and Ostrom et al. (2001), using the Institutional and Development Analysis (IAD) framework. The key insight from Fraser and Whitfield (2008), in contrast to much of the literature on the political economy of aid, lies in seeing the engagement between recipient country governments and donors as one of negotiation, since it is assumed that their objectives may diverge. Fraser and Whitfield (2008) also focus on the importance of both the economic and political contexts in shaping country and donor negotiations, and thereby negotiation outcomes. Drawing on the IAD framework, we also emphasise the importance of negotiation arenas. Rather than taking these as a given, we ask whether governments seek to engage with different kinds of providers of development finance in the same fora. We focus particularly on arenas related to in-country aid coordination (e.g. sectoral or technical working groups and regular high-level donor–government meetings) as these are often key fora in which donors and government engage in discussion of sectoral strategies, project identification, policy dialogue and conditionalities.

Section 2 of this report highlights the main elements of the economic, political, governance and aid-management system influencing the negotiating capital of the Government of Uganda regarding various providers of development finance. Drawing on this theoretical framework, we sought to answer the following main research questions for the case of Uganda.

- **Volume of flows** (Section 3): Does the country receive external development finance beyond ODA and has the volume increased since the early 2000s?
- **Priorities and characteristics of development finance** (Section 4): What are the Government of Uganda's priorities for the type of development finance it receives and how do these change across ministries and sectors?
- **Arenas for the negotiation of development finance** (Section 5): In which fora does the Government of Uganda seek to engage with providers of development finance beyond ODA, and what strategies does it employ to negotiate with them? How do these differ from the fora and strategies in which the Government of Uganda engages with ODA donors?
- **Outcomes** (Section 6): To what extent is the Government of Uganda achieving its objectives in negotiating with the providers of development finance? How is the existence of development finance flows beyond ODA helping or hindering the country in achieving its objectives?

Box 1: Official development assistance and other official flows (OOFs)

The OECD-DAC classification of ODA covers finance provided by official agencies, including state and local governments, or their executive agencies, which is:

1. administered with the promotion of the economic development and welfare of developing countries as its main objective, and
2. concessional in character and conveys a grant element of at least 25% (calculated at a rate of discount of 10%).

OOFs do not meet either or both of these conditions. In December 2014 the DAC High-Level Meeting revised the criteria for concessional loans, so that only the grant element will now be counted as ODA. A new set of discount rates and risk adjustments is to be based on the income classification of the recipient country (OECD-DAC, 2014).

We define 'government' here as central agencies (including the Ministry of Finance, Planning and Economic Development (MFPED), the National Planning Authority and other apex institutions, such as the Presidency) and line agencies. We assume that the government will have different sets of priorities and types of engagement with the different actors. This analysis does not reflect civil society priorities, which may well differ from those of the government.

There are several reasons for the choice of Uganda as a case study. Since the mid-2000s, Uganda's budget financing has become less dependent on ODA, while the government has significantly oriented its national development priorities away from social-sector spending and towards infrastructure development. The discovery of commercially viable oil reserves has boosted the country's drive to develop its economic infrastructure, with the aim of becoming a lower-middle-income country by 2020. These shifts have been accompanied by an increase in the sources of financing available to the government, including through greater engagement with non-DAC donors (particularly China), resumption of lending by some bilateral OECD-DAC donors with limited grant financing (following Uganda's attainment of debt relief) and increased involvement of smaller Islamic multilateral development institutions. Other new potential sources of financing include less-concessional lending from the African Development Bank (AfDB), access to international bond markets and contractor-facilitated financing through PPPs.

To the best of our knowledge, there is no existing case study on how financing choices in Uganda are made at the level of the MFPED and beyond. This case study will aim to fill this gap. The research was conducted through semi-structured interviews held in Kampala from 8 to 24 April 2015 with approximately 40 key informants (see Annex 4), supplemented by data analysis and reviews of key documents.

2 Country context underpinning Uganda's negotiating capital

This section sets out the key aspects of Uganda's economic, political, governance and aid-management contexts that shape the Government of Uganda's negotiating capital with providers of development finance.

Uganda has made significant progress in reducing poverty levels over the past two decades. The percentage of the population living below the poverty line has fallen from over 56% in 1992 to below 20% in 2012/13 (UBS, 2014a), spurred by high levels of real growth and low inflation rates. Real GDP growth averaged 8.5% per annum in the 1990s, and has averaged 6.9% per annum since 2000/01.[4] GDP per capita has almost quadrupled in dollar terms in two decades; by 2013/14, it amounted to $788 per person, boosting the country's hopes of becoming a lower-middle-income country with a per capita GDP of $1,000 by 2020. However, the benefits of growth have not been geographically even: 44% of the population in Northern Uganda is currently living in poverty, compared with just 5% in the Central Region. Inclusive, poverty-reducing growth is also proving a challenge along other dimensions: income inequality remains relatively high in urban areas,[5] while inequality within regions has also started rising for the first time in over a decade.[6]

Uganda's strong track record in growth, economic management and poverty reduction since the 1990s has been an asset in its relations with external development providers (Williamson et al. 2016). Uganda was the first country globally to benefit from debt relief under the Highly Indebted Poor Countries initiative in the late 1990s. It also benefited from the Multilateral Debt Relief Initiative (MDRI) in the mid-2000s, and was the first country globally to enter into a non-financial Policy Support Initiative (PSI) arrangement with the International Monetary Fund (IMF). The PSI is used to monitor Uganda's macroeconomic management, and establishes limits agreed between the government and the IMF on deficit financing and volumes of non-concessional borrowing.

Uganda's priorities for external development assistance have shifted over time, from social sectors to infrastructure. Between 1997 and 2010, Uganda's priorities for donor assistance were guided by successive Poverty Eradication Action Plans led by MFPED. These placed significant emphasis on poverty reduction through expanded access to basic social services. However, in the mid-2000s, political priorities started to shift towards economic transformation through infrastructure development. This priority shift was fully reflected in the first National Development Plan (NDP), which commenced in 2010 under the leadership of the National Planning Authority. The second phase of the NDP, which has just been approved and will run to 2020, continues this prioritisation.

Government dependency on external development assistance has reduced over the past decade. Between 1999/00 and 2004/05, aid accounted for 49% of budget resources.[7] In the mid-2000s, following concerns about the macroeconomic impacts of aid dependency (Williamson et al. 2016), the Government of Uganda introduced a policy of reducing external financing as a share of government expenditure. By 2013/14, aid accounted for less than 15% of budget financing, as the deficit excluding grants reduced from a peak of almost 12% of GDP in 2001/02 to below 5% by 2013/14.[8] However, overall government expenditure has remained constrained by the relatively low level of domestic resource mobilisation. Domestic revenues increased from only 10.5% of GDP in 2000/01 to 13.0%

4 Source: MFPED data and UBS (2014b).

5 The Gini coefficient for urban areas was 0.41 in 2012/13, compared with 0.341 for rural areas.

6 Income inequality within regions fell from 83% in 2002/03 to 79.3% in 2009/10, but then rose to 82.1% in 2012/13.

7 Source: Data provided by MFPED during interviews.

8 Source: Data provided by MFPED during interviews.

in 2013/14,[9] and Uganda has the lowest tax-to-GDP ratio in the region (IMF, 2015). Nonetheless, domestic pressure has grown for significant investment in infrastructure-related expenditures to support the priorities set out in the NDP.

Uganda's relatively low level of external debt following MDRI debt relief has given it scope to borrow to fund infrastructure priorities (IMF, 2015). Following MDRI debt relief in 2007, Uganda's external debt amounted to 11% of GDP. By 2014, the external debt-to-GDP ratio had risen to 16% of GDP. It is expected to double again over the next six years, exceeding 30% of GDP by 2020, as the government borrows to finance its priority infrastructure-related investments (IMF, 2015). The government anticipates that significant investment to alleviate infrastructure bottlenecks in the next five years will enable Uganda to achieve its objective of graduating from low-income to lower-middle-income country status by 2020.

Although Uganda has scope for new borrowing, it faces challenges in absorbing external financing in a timely and effective manner. MFPED has consistently raised concerns about slow loan disbursement rates, which raise the cost of servicing external debt by increasing commitment fees. It attributes the slow disbursement to poor project preparedness among implementing institutions, as well as to weaknesses in implementation capacity, including poor project and/or contract management, procurement-related challenges and financial management inadequacies (MFPED, 2014). On average, 39% of Uganda's external debt stock has remained undisbursed since 2008 (MFPED, 2015a). MFPED is concerned that continued poor performance may make it difficult for government to access soft loans in future, since commitment and disbursement decisions are based on recipients' abilities to meet project objectives during planned timelines (MFPED, 2015b). External analysis has pointed to the difficulty of improving performance in sectors, such as roads, where there is pressure to use financing to provide political rents (Booth et al. 2009).

Uganda's relationship with OECD-DAC donors has been adversely affected over the past decade by governance concerns relating to conduct of elections, corruption and human rights (Williamson et al. 2016; Barkan, 2011). This has led to a reduction in direct funding to government, particularly budget support.[10] By 2013/14, budget support accounted for just 12% of aid provided direct to government, compared with an average of 55% in the five years from 2000/01.[11] However, other factors also play into the relationship, including Uganda's active role in combating extremism in the region through its engagement in Somalia (Barkan, 2011) and OECD-DAC donors' commercial interests in Uganda (Booth et al. 2014). Varying agendas and interests mean that donors are considered more likely to change the mode of their aid in response to governance concerns, rather than reduce it on a permanent basis (Booth et al. 2014). In addition, the increasing availability of financing from non-DAC donors, especially China, is considered a factor in diminishing OECD-DAC donors' influence on the government, as is Uganda's discovery of commercially viable reserves of oil (Booth et al. 2014). However, as noted by several interviewees, revenues from oil are not expected until after 2020.

Uganda's relationships with non- DAC donors, particularly China, have strengthened considerably over the past decade. China has had a longstanding relationship with Uganda, dating back to independence (Guloba et al., 2010), which has included providing grant support for economic development, technical assistance and small-scale concessional loans. Over the past decade, China has become a significant trading partner (accounting for 10.9% of all imports in 2013/14, compared with 3.2% 14 years ago),[12] and is emerging as a significant source of funding for major infrastructure projects identified in the NDP, including roads, hydropower dams, air-transport infrastructure and, potentially, the Standard Gauge Railway. Following a recent trip to China, President Museveni was quoted as saying 'China is key to Uganda's economy ... China is assisting us with basic programmes such as infrastructure, which other friends did not care about'.[13]

Uganda is vulnerable to the impacts of climate change. Many households depend on crops that are vulnerable to increasing temperatures and dry-season rainfall, and have limited buffers to cope with additional stress (Caffrey et al., 2013). The expected impacts of climate change in Uganda include droughts, floods, storms, heatwaves and landslides, with anticipated serious consequences for agricultural production, food security, forests, water supply, infrastructure, health systems, incomes, livelihoods and overall development (Government of Uganda, 2015). The government has recently approved a National Climate Change Policy that focuses on providing direction for the key sectors that will be affected by the impacts of climate change, facilitating adaptation and strengthening coordinated efforts among sectors to build resilience. The government aims to access international climate financing and technological assistance to strengthen its mitigation policies and practices (Government of Uganda, 2015).

9 Source: Data provided by MFPED during interviews.

10 Budget support peaked at $671m in 2006/07 (MFPED data). It fell to $323m in 2009 and just $82m in 2012. It rebounded slightly to $111m in 2013 (OECD CRS).

11 Source: Data provided by MFPED during interviews.

12 Source: Bank of Uganda.

13 *New Vision*, 1 April 2015.

3 Development finance in Uganda

This section looks at whether Uganda currently receives external development finance beyond ODA, and whether the amount it receives is expected to increase in the coming years. It also reviews the evolution of total development finance to Uganda since 2000 (see Box 2 for definitions). The analysis of development finance beyond ODA also looks at the use of instruments such as PPPs.

The analysis presented in this section uses the OECD-DAC definition of concessionality to assess whether development financing provided by OECD-DAC donors and multilateral development institutions is concessional, and therefore qualifies as ODA, or is non-concessional, and therefore qualifies as development finance beyond ODA. The OECD-DAC definition of concessionality differs from that used by the Government of Uganda (Box 3).

3.1 Overview

Total external development finance to Uganda, including debt relief, amounted to $22.4bn between 2002 and 2013. It almost tripled from $707m in 2002 to just over $1.9bn in 2009, and has remained fairly constant in nominal terms since (Figure 1), although it has declined significantly as a share of GDP. As of 2013, total external development finance to Uganda amounted to 7.6% of GDP, compared with a peak of 14.8% in 2004 (excluding the debt relief related spike in 2006). Loan financing accounted for less than a quarter of total external development finance to Uganda between 2002 and 2013 on average, but by 2013 the share of loans in total development assistance had risen to 32%.

Box 2: Defining external development assistance

This report divides external development assistance to Uganda into two main categories:

- ODA-eligible concessional financing from OECD-DAC donors and multilateral development institutions, and
- development finance beyond ODA.

Development finance beyond ODA is defined as including:

- non-concessional financing from OECD-DAC donors and multilateral development institutions (OOFs)
- financing from non-DAC donors (both concessional and non-concessional), philanthropists and multilateral climate funds, and
- international sovereign bonds.

Box 3: Comparing OECD-DAC and the Government of Uganda definitions of concessionality

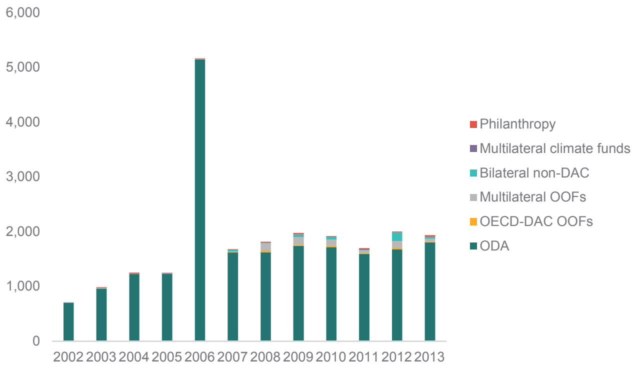
OECD-DAC currently defines development financing as concessional, and therefore eligible to be classified as ODA, if it has a grant element of 25%, calculated at a discount rate of 10%.

Uganda's 2013 Debt Management Framework uses a grant element of 35% as its concessionality threshold, calculated at a discount rate of 5%.

To date, external development finance to Uganda has been almost entirely ODA. On average, official development finance beyond ODA accounted for just 6.3% of total development finance to Uganda between 2002 and 2013, as compared to the cases of Cambodia, Lao PDR and Ghana, whose average share between 2010 and 2012 was above 45%. The highest share recorded was 16.1% in 2012, when Chinese road infrastructure financing for the Kampala–Entebbe Highway started to disburse.

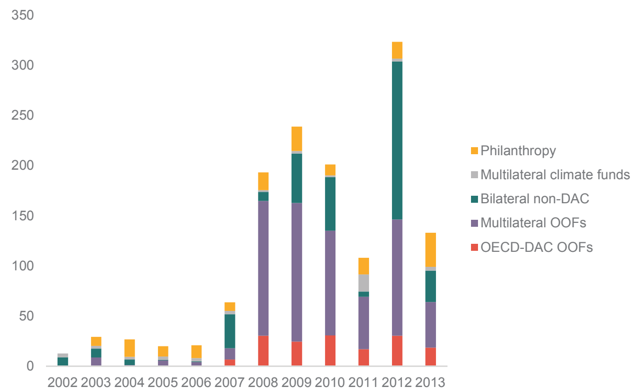
In total, external development finance flows beyond ODA amounted to $1.4bn between 2002 and 2013, representing an average flow of $114m per year (Figure 2).

Figure 1: Development finance per annum to Uganda, 2002-2013 ($m)



Source: Data on ODA from the OECD CRS for DAC donors and multilateral development institutions; beyond-ODA data are the sum of OOFs (OECD DAC2b); climate finance (OECD CRS (GEF) and Climate Funds Update); loans and grants from China (MFPED and AidData); loans and grants from non-DAC donors (DAC2a and AidData); and philanthropic flows (Foundation Center).

Figure 2: Beyond-ODA finance per annum to Uganda, 2002-2013 ($m)

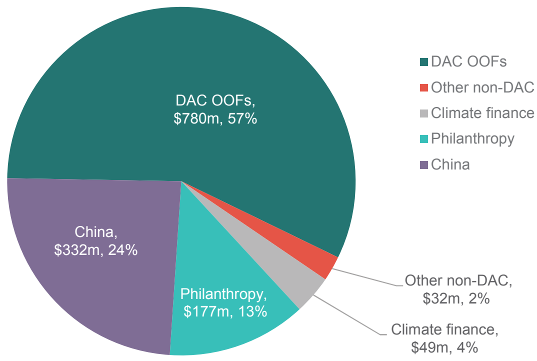


Source: As for Figure 1.

Of this total, 24% ($332m) was provided direct by China as government-to-government assistance (Figure 3), mainly loans, with Chinese flows increasing from an average of $13.5m per year (2002-2009) to $56m per year (2010-2013). Disbursements to government from non-DAC donors other than China amounted to just $31.9m in 12 years. OOFs from OECD-DAC donors and multilateral development institutions amounted to $780m over the 12-year period, averaging $65m per year. Philanthropic flows amounted to $177m, or an average of $15m per year, the bulk of which flowed direct to non-government entities. Multilateral climate finance amounted to $49m, at an average of $4.1m per year.

In the past year, there has been a step change in the Government of Uganda's beyond-ODA commitments, as the Ugandan Parliament approved $1.96bn of non-ODA loans, primarily from China, in 2014/15. These constituted 72% of the new borrowings approved by Parliament in 2014/15, and 67% of total new external financing commitments including grants.

Figure 3: Total beyond-ODA finance to Uganda, 2002-2013



Source: As for Figure 1.

Box 4: Role of non-ODA loans in the Government of Uganda's future financing plans

The Government of Uganda's committed and planned future external financing to 2025 amounts to $12.5bn (Annex 1).[a] Some 85% of this (or $10.7bn) is expected to be loan financed. These figures do not include grants from OECD-DAC donors that will be channelled direct to non-government entities, which could amount to almost $1bn per year,[b] but they nonetheless indicate the extent to which loans are set to play a significantly larger role in the financing landscape in Uganda in the coming decade.

Non-ODA loans are expected to constitute 70% of new government borrowings to 2025/26, amounting to $7.4bn in value. Borrowing from China Exim Bank is expected to account for almost 80% of all non-ODA loans over the period. Non-ODA loans from OECD-DAC donors and multilateral institutions are expected to account for 20% of non-ODA borrowing to 2025. Most of this is expected to be non-concessional lending from multilateral development institutions (such as the Islamic Development Bank and the AfDB), but it also includes commercial loans from the UK and Japan, which are currently pending Parliamentary approval.

Notes:

[a] *Authors' calculations based on data available in MFPED (2015a).*

[b] *ODA grants from OECD-DAC bilateral donors and multi-laterals averaged $1.29bn per annum in 2012 and 2013, while MFPED data indicate that grants that flowed through the budget during this period amounted to $320m per annum.*

At the end of 2014/15, further non-ODA loans to the value of $813m were pending Parliamentary or Cabinet approval in 2015/16, constituting 52% of the new loans pending approval. Overall, the Government of Uganda expects to take on $7.4bn of non-ODA loans to 2025 (Box 4).

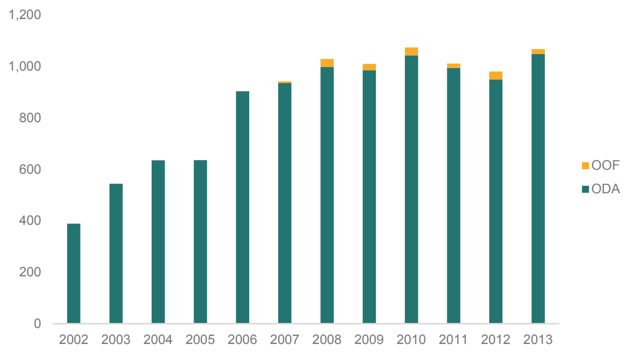
3.2 OECD-DAC donors

OECD-DAC donors have provided over $10.2bn in assistance to Uganda since 2002, including debt relief of $42m. Assistance from OECD-DAC donors rose rapidly in the early 2000s, peaking at 8.2% of GDP in 2006. It has generally continued to rise in nominal terms, and exceeded $1bn in 2013. However, the rate of increase has slowed significantly, and this type of assistance has declined as a percentage of GDP, falling to just 4.2% in 2013.

To date, almost all assistance from OECD-DAC donors (over 98%) has qualified as ODA (Figure 4). Only $160m of recorded flows between 2002 and 2013 qualify as OOFs. These bilateral OOFs predominantly relate to the financing of the private investor involved in the Bujagali Hydropower Project. France (through PROPARCO), the Netherlands (through FMO) and Germany (KfW) are reported to have provided debt financing to the private investor in the Bujagali Hydropower Project (see Section 3.8 for details).

A number of OECD-DAC donors have also been providing financing to the private sector, to enable it to work in partnership with government through PPPs. The UK's Department for International Development (DFID) (through the Private Infrastructure Development Group (PIDG)) has provided equity, debt, grant and guarantee financing to the Kalangala Infrastructure Services project (see Section 3.8). The US has also provided a guarantee against the private developer's debt. Under the GETFiT programme, the UK, Norway, the EU and Germany use ODA resources to provide subsidies to the feed-in tariff for small-scale renewable energy producers. A number of OECD-DAC donors have also expressed interest in

Figure 4: Funding from OECD-DAC donors, 2002-2013 ($m), ODA/OOF split



Source: As for Figure 1.

involvement in future infrastructure PPPs – for example, the Kampala–Jinja Highway and Kampala Southern Bypass.

Germany (KfW) and France (AFD) are actively blending their loan financing with grants on a project basis, so that the overall concessionality of financing to an individual project remains within the Government of Uganda's concessionality threshold. In general, these loans still meet the ODA definition of concessionality, although the interest rates on the French loans are set at a variable margin to EURIBOR (between 0.25% and 6%), with the margin determined on the day of disbursement. The loans qualify as ODA if the minimum margin is applied, but are OOFs at the maximum margin. To date, the margins applied have been at or close to the minimum.

The EC's support to the road sector in Uganda under the 11th European Development Fund (EDF) has to be provided through blending operations, following a revision to EDF policy on road financing. The EC is therefore actively exploring potential partnerships with loan providers, such as the European Investment Bank (EIB) and the AfDB. It already has experience of providing blended road financing with the EIB, for example on the Mbarara Bypass, where the EIB provided loan financing

Box 5: Examples of blended financing from OECD-DAC donors

Kampala Water and Sanitation Project: The EIB and France (AFD) provided loans amounting to €75m each, blended with a grant from Germany (€20m). France also accessed a €14m grant from the EU Infrastructure Trust Fund to subsidise its loan interest rate.

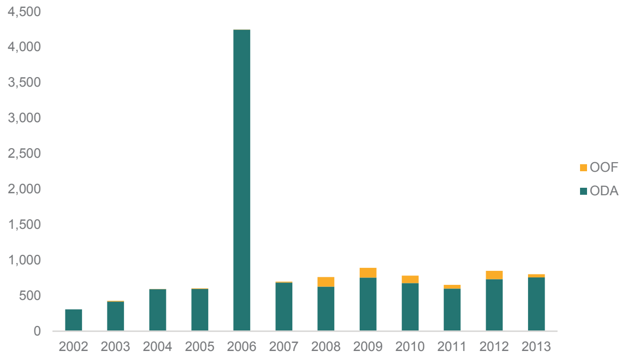
Kampala–Entebbe Transmission Line: Germany (KfW) blended a loan of €15m with a grant of €5m.

Hoima–Nkenda Transmission Line: France (AFD) provided a loan of $23m, blended with a grant from Norway of $54m.

Musizi Hydropower: It is anticipated that loans will be provided by Germany (KfW – €40m) and France (AFD – €45m), blended with a grant from Germany (KfW – €5m).

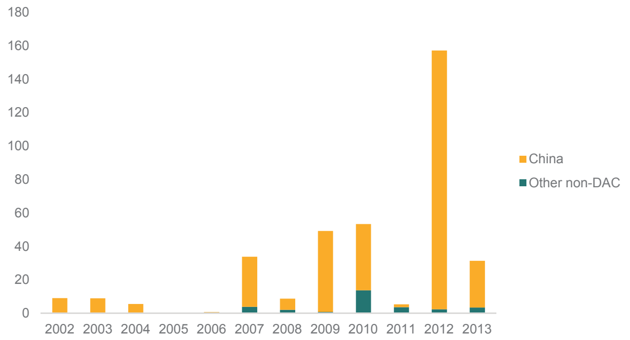
Rural Electrification Grid Extension: It is anticipated that France (AFD) will provide a loan of €43m, blended with a grant of €8m using funds delegated from the EU-Africa Infrastructure Trust Fund to AFD.

Figure 5: Funding from multilateral development institutions, 2002-2013 ($m), ODA/OOF split



Source: As for Figure 1.

Figure 6: Funding from non-DAC donors, 2002-2013 ($m)



Source: As per Figure 1.

for construction, while EU grant funding supported project supervision.

Two new OOF loans to the Government of Uganda, amounting to $286m, are expected to be approved by Parliament in 2015/16. These loans, from Japan (JBIC) and the UK (ECGD), are on commercial terms and tied to specific contractors. The loans will be used to acquire earth-moving equipment and upgrade roads in the oil-producing Albertine Rift region.

3.3 Multilateral development institutions

Multilateral development institutions have provided assistance amounting to $7.7bn to Uganda since 2002, excluding debt relief, which amounted to $3.9bn. Assistance from multilateral development institutions rose rapidly in the early 2000s, peaking at 6.3% of GDP in 2004 (excluding debt relief). Since then, provision of support on an annual basis has been variable, peaking in nominal terms at $890m in 2009.

Some 95% of assistance from multilateral development institutions between 2002 and 2013 has qualified as ODA (Figure 5). The International Finance Corporation (IFC) ($260m), EU ($215.5m) and AfDB ($145m) have been the main multilateral providers of OOFs, according to the OECD.[14] Multilateral OOFs have increased from an average of $6.1m per year (2003-2007) to $98.3m per year (2008-2013).

The bulk of AfDB's non-ODA support relates to its involvement in the Bujagali Hydropower Project, where it provided loan financing to the private-sector developer ($123m in disbursements over the period 2008-2012). It has also lent direct to the private sector within tourism (for the Sheraton Kampala Hotel – $7.8m disbursement in 2003) and the financial intermediation sector ($15m in disbursements over the period 2012-2013). Lending by EU institutions comprised a series of EIB loans to support a private-enterprise facility managed through the Central Bank and the EIB, as well as EIB involvement in the Bujagali Hydropower Project. The IFC was also a major player in the Bujagali Hydropower Project.

The Government of Uganda has entered into $255m of OOF commitments with the Islamic Development Bank (IDB) but, by the end of 2013, they had not started to disburse. Since 2012, the government has entered into a number of loan agreements with IDB on terms that do not meet ODA concessionality criteria and therefore qualify as OOF. These are in the agriculture sector ($34.05m for a rice food-security project), health sector ($20m for specialised maternal and neonatal healthcare at Mulago hospital), electricity sector ($80.62m for the Opuyo–Moroto electricity transmission line project) and the transport sector ($120m for projects relating to the upgrading of the Tirinya–Pallisa–Kumi and Pallisa–Kamonkoli roads).

The Ministry of Finance anticipates that the government will borrow a further $1.1bn from AfDB and IDB on terms that do not meet ODA concessionality criteria in the coming years. IDB non-concessional financing will mainly be for transmission lines, health (Mulago hospital) and roads, while AfDB financing will be for roads (including the Kampala–Mpigi expressway) and transmission lines.

3.4 Bilateral non-DAC donors

Non-DAC donors provided $364m of assistance to Uganda between 2002 and 2013, accounting for just 1.6% of external development finance over the period. China provided 91% of Uganda's non-DAC flows between 2002 and 2013 (Figure 6).

Development assistance from China amounted to $332m between 2002 and 2013, of which $66m was grant financing and $266m was loans.[15] Grant disbursements have included $43m for the construction of government

14 DAC2b table.

15 Source: Aid Data and MFPED.

buildings and $3m for the construction of primary schools. Loan disbursements have included $95m for the national information backbone project (loan fully disbursed), $50m for road equipment (against a total loan value of $100m) and $122m for the Kampala–Entebbe Express Highway (against a total loan value of $350m). These loans have been provided by China Exim Bank through its 'preferential' window, where the terms are not fully commercial as they offer a fixed interest rate of 2% against a 20-year loan term, which has a five-year grace period.

According to the OECD CRS, other active non-DAC donors include Kuwait, the United Arab Emirates and Saudi Arabia, but on a very small scale. Kuwait distributed $2m in grants in 2011 (Kuwait Goodwill Fund, for the promotion of food security in Islamic countries) and $1m in loans in 2013 (for the Uganda Development Bank Ltd, against a commitment of $10.5m) and has an outstanding debt of $22m as of February 2013. Kuwait also committed $12.5m to construct and equip four technical institutes in 2012, though this amount remained undisbursed as of February 2015. The United Arab Emirates distributed $1.2m in grants between 2009 and 2013, primarily for the education sector, as well as activities in the water and conservation sectors. Saudi Arabia has also provided loans on a small scale.[16]

Borrowing from China and other non-DAC bilaterals is expected to increase significantly in the coming years. Of $10.7bn in new borrowings anticipated to 2025/26 (see Box 4), more than half ($5.9 billon) is expected to come from non-DAC bilaterals. Of this, 99% is expected to come from China.

In 2014/15, Parliament approved new loans from non-DAC donors amounting to $1.955bn. These included $1.918bn from China Exim Bank, for the construction of the Karuma and Isimba hydropower dams, and $15m from the Saudi Fund for the rehabilitation of general hospitals. Three further China Exim Bank loans, amounting to $527m, are expected to be approved by Parliament in 2015/16. These loans are for the rehabilitation of Kampala Airport ($325m), the construction of four industrial parks ($95m), and defence equipment ($107m).[17] In addition, the Government of Uganda also expects to borrow $3.2bn from China Exim Bank in the next five years for the Standard Gauge Railway, and $200m for the subsequent phases of the rehabilitation of Entebbe Airport. In the longer term (after 2020), the Government of Uganda also expects to borrow $45m from India Exim Bank for the Uhuru hydropower dam project.

3.5 Philanthropic and NGO assistance

Philanthropic organisations are active in Uganda, and available data from different sources[18] show they provided $177m[19] in funding between 2002 and 2013, primarily channelled direct to the non-government sector. Since the data are fragmented, this figure may understate total philanthropic assistance to Uganda. The largest recorded philanthropic provider is the Bill and Melinda Gates Foundation, which is reported to have disbursed $158m in private grants[20] between 2009 and 2013, at an average of $26m per year. Other philanthropic organisations known to be active in Uganda include the William and Flora Hewlett Foundation ($7.4m in disbursements recorded from 2009 to 2013),[21] the Stars Foundation,[22] the Stromme Foundation,[23] the MacArthur Foundation, the Rockefeller Foundation, the Aga Khan Foundation and the Gatsby Foundation.

There are just two reported instances of direct philanthropic financing to the Government of Uganda, amounting to just $1.9m. Between 2003 and 2004, the Ministry of Finance and Economic Planning and Development received three grants from the Rockefeller Foundation totalling $0.4m.[24] More recently the Ministry of Lands, Housing and Rural Development received total funding of $1.5m from the Bill and Melinda Gates Foundation for a project 'to increase access to improved municipal infrastructure for the poor in Uganda'.[25] Beyond this, the Government of Uganda does not appear to be particularly engaged with the private grants of

16 The OECD (DAC2a table) also indicates lower levels of support from Cyprus, Estonia, Hungary, Israel, Russia, Thailand and Turkey. AidData also shows commitments from Brazil, India and South Africa.

17 However, recent newspaper reports indicate that this loan may actually be from Russia rather than China (*New Vision*, 14 July 2015: 'Defence clarifies on loan from Russia').

18 OECD CRS, Development Initiatives, Foundation Center, information provided in interviews.

19 Source: Foundation Center (http://foundationcenter.org/).

20 Source: OECD CRS.

21 Source: Development Initiatives (http://d-portal.org/).

22 Source: Development Initiatives.

23 An NGO providing microfinance, which receives funding from Norway. The representative interviewed for Norway also made mention of a small group of individuals financing a health facility in Jinja.

24 Source: Foundation Center.

25 Foundation Center and OECD CRS.

philanthropic organisations,[26] and does not possess a good overview of their flows and activities.

There are some examples of philanthropic foundations engaging in the private-sector components of PPP arrangements with government. The Aga Khan Foundation is an important player and financier in the energy sector. Chief among these is its involvement as a shareholder in Bujagali Hydropower Project (see Section 3.8). However, it is also involved in the West Nile Rural Electrification Company (WENRECo), where it is reported to have funded losses in the early years of the concession. The Rockefeller, Gatsby and Gates Foundations have financed the private equity in the Kalangala Infrastructure Services PPP.

Philanthropic organisations are also actively involved in the financial intermediation sector. The Gatsby, Rockefeller and Gates Foundations have invested a combined $17m in the regional African Agriculture Capital Fund managed by Pearl Capital.[27] The Fund receives partial debt guarantees from the US. The Gates Foundation and the MasterCard Foundation are heavily involved (including board membership), and DFID's Financial Sector Deepening Programme provides market research and mapping, pilot funding for financial innovations and support for financial regulations. The Gates Foundation also provides tactical grants for work on regulations and the MasterCard Foundation has provided significant loan financing ($50m) to the NGO BRAC.

NGOs have not noted a marked shift in their funding sources, and traditional development partners continue to be the primary source. Non-traditional sovereign donors have not been instrumental in funding the NGO sector as they are focused on government, although a number of the Islamic bilaterals and development finance institutions support faith-based organisations. Some of the bigger philanthropic organisations are reported to provide finance that gives NGOs scope to innovate in the way they implement programmes and projects. Some of this is coming to an end, such as support in the education sector from the William and Flora Hewett Foundation, but other foundations continue to operate as before. Some NGOs are working with private-sector companies engaged in activities related to corporate social responsibility, but the funding is reported to be small.

3.6 Climate finance

Levels of multilateral climate financing to Uganda are fairly low. Uganda has received $49m in multilateral climate finance since 2002. The funds to date have largely been disbursed from the Adaptation Fund to accredited agencies operating in Uganda, as government has not been able to access multilateral climate financing directly. Funding has been accessed through the Global Environment Facility (GEF), and its sub-funds,[28] for the development of National Adaptation Programmes of Action (UNEP), an early warning system for the Uganda National Meteorological Authority (UNDP), a water and sanitation project (AfDB) and a food security project (UNIDO). The FAO has an application pending for a food security and water catchment project. Total flows through the GEF have amounted to $34m between 2002 and 2013, at an average of $2.85m per year. The Ministry of Water and Environment (MWE) is currently submitting an application for a water catchment areas project through SAHEL, a regional organisation accredited to access funds directly from the Adaptation Fund, without going through the GEF. Separately, funding from the Global Climate Change Alliance (GCCA) is administered by the EC and has been accessed by the FAO for a livestock programme.[29] In 2011 Uganda accessed $14.67m in disbursements from the GCCA.

The Government of Uganda has been taking steps to access multilateral climate finance directly. The process for applying for accreditation started in 2012. UNDP is providing support to the Government of Uganda to attain accreditation to access both the GEF and the Adaptation Fund directly. The Government of Uganda has experienced problems in accessing the Adaptation Fund in particular; interviewees for this report describe the accreditation process as time consuming. In 2013 a large water project submission by the Government of Uganda to the Adaptation Fund was rejected, hence the application through SAHEL in 2015. The Government of Uganda is also receiving support from Germany to be accredited to

26 However, the Office of the Prime Minister is involved with the Millennium Villages Projects.

27 Source: USAID, which provides a 50% guarantee to the debt provider – the JP Morgan Social Finance Unit.

28 According to Climate Funds Update, Uganda has been accessing the Least Developed Country Fund (LDCF) through ADB, UNEP, UNIDO and UNDP, although the database shows approvals and no disbursements.

29 According to Climate Funds Update: the GCCA has disbursed $14.67m of approvals of $20.67 for adaptation to climate change; the Forest Carbon Partnership Facility (FCPF) has disbursed $0.47m of approvals of $3.8m for readiness preparation, which is understood by MFPED to be accessed through the FAO Redd Plus programme in conjunction with the Forest Sector Support Department in MWE; the Adaptation for Smallholder Agriculture Programme (ASAP) has approved $10m for the Programme for the Restoration of Livelihoods in the Northern Region (PRELNOR), understood by MFPED to be managed by FAO (although DFID noted IFAD and CGIAR as implementers) but has yet to disburse; and the UK's International Climate Fund (ICF) has made approvals of $1.9m but no disbursements (contrary to the understanding from interviews that the ICF is the main funder of the GETFiT programme).

access the Green Climate Fund as well.[30] Accreditation steps include the development of a climate change strategy,[31] the establishment of a national designated authority (NDA) and a national implementing agency (NIE).[32] In the interim period, the Government of Uganda is hoping that Germany can access the Green Climate Fund on its behalf.

The process for accessing bilateral climate finance is less clear. The Government of Uganda initially thought that climate finance from bilaterals would be a new and additional funding source. However, the Government of Uganda's representatives have noted that this does not appear to be the case, and that development partners tend to 'tag' an entire development project as being 'climate finance' if the project has a climate component. The Government of Uganda is also unclear whether bilateral climate finance projects are using their own funds or accessing multilateral climate funding. The UK's International Climate Fund (ICF) is a source of financing for the GETFiT programme (£49.5m), the Resilience in Karamoja programme (£38.5million) and the NuTech climate-smart agriculture programme in the north of Uganda (£58m). The ICF (initial global commitment of £2bn globally) is an example of bilateral climate finance that was intended to be a separate funding source, providing additional financing, but it has become a mechanism for funding country office programmes, which in the case of Uganda has served to maintain country funding at existing levels, making it hard to identify any additionality. Among other bilaterals, Norway and Japan are also providers of bilateral climate finance, although on a smaller scale. Norway noted it has limited funding for very small projects and limited involvement; JICA provides support for a wetlands programme in Eastern Uganda.

3.7 International sovereign bonds

The Government of Uganda has not issued international sovereign bonds to finance public-sector investments, and has no plans to do so in the near future. Section 6 further elaborates on this point.

Box 6: An example PPP – Bujagali Hydropower Project

This 250 MW power-generating facility on the Nile river, near the town of Jinja, was developed under PPP arrangements at a total cost of approximately $900m, commencing in 2007. At the centre of the project is Bujagali Energy Limited (BEL), which holds:

- a 30-year build, operate and transfer (BOT) contract with the Uganda Electricity Transmission Company Ltd (UETCL) and the Government of Uganda
- a power purchasing agreement (PPA) with UETCL/Government of Uganda
- a guarantee from the Government of Uganda for UETCL's payment obligations or any other loss arising from UETCLs failure to honour its obligations under the PPA.

BEL is a project-specific company with an 80:20 debt-to-equity structure. The equity providers are IPS[a] and SG Bujagali Holdings Ltd.[b] Their $151m combined investment is underwritten by a $115m 20-year political risk insurance guarantee from the Multilateral Investment Guarantee Agency (World Bank). The Government of Uganda holds a 12% ($20m) equity stake.[c] Debt in the amount of $686m was secured from commercial banks[d] and multilateral and bilateral lenders. Commercial bank debt benefits from a partial risk guarantee from the International Development Association (IDA, World Bank).

Notes:

a *Industrial Promotion Services (Kenya) Limited, which is part of The Aga Khan Fund for Economic Development.*

b *This is the result of the Government of Uganda holding the intellectual property rights from the previously unsuccessful attempt at the same project which it transferred to BEL for its equity stake.*

c *Standard Chartered and ABSA.*

d *Proparco (French), FMO (Dutch) and KfW (German).*

30 KfW, as one of the six currently accredited agencies for the Green Climate Fund, is assisting in identifying bankable projects through the development of sector concept notes, while GiZ is supporting MFPED as the national designated authority through its readiness programme. KfW is also supporting the East African Development Bank to become a regional implementer.

31 According to the MFPED Aid Liaison Office, the National Policy on Climate Change was approved by Cabinet on 1 April 2015 with changes, but it is not yet available on the Ministry's website.

32 For Uganda these are MFPED and the MWE respectively.

3.8 Public–private partnerships (PPPs)

The Government of Uganda adopted a national PPP policy in 2010, and Parliament has just passed a revised PPP Bill. The objective of the national PPP policy is to encourage private-sector investment and participation in public infrastructure and related services where value for money can be clearly demonstrated. The Bill provides for the roles and responsibilities of each stakeholder in the PPP implementation process, and the institutional framework that guides them. Passage of the Bill was delayed by a disagreement between the executive and the legislature on the role of Parliament in approving PPPs.[33] The President is reported to have refused to sign into law the initial Bill passed by Parliament in 2014, as it gave MPs powers to approve PPPs. This clause has been dropped in the revised version of the Bill that was passed by Parliament in July 2015.

The Government of Uganda has engaged in a number of PPPs since 2003 across a number of sectors, and plans to continue doing so in future. Existing PPPs include Bujagali Hydropower Project, Kalangala Infrastructure Services (KIS), Umeme Electricity Distribution Project, Kampala Serena Hotel Project, Eskom Electricity Generation Project, Kenya–Uganda Railway Project, and Kilembe Mines Limited Project. Planned PPPs include an oil refinery, the construction of Uganda Police Headquarters, expansion of the Kampala–Jinja road and the relocation of Kigo Prisons (MFPED, 2015a).

Quite a number of the PPPs to date have involved commitments of development finance beyond ODA. By far the largest of these is the 250 MW Bujagali Hydropower Project (Box 6), where multilateral and bilateral development finance institutions, including AfDB, EIB, IFC, France, Germany and the Netherlands, committed debt financing to the private developer in a project worth over $900m across a 30-year period. The KIS PPP (worth $44.5m) is providing solar electricity, potable water, ferry services and an upgrade of the road network for Bugala Island. It is financed via private-sector equity (UK through InfraCo Africa and philanthropic organisations), commercial lending (guaranteed by USAID and the UK through Guarantco), lending from development finance institutions (the UK through the Emerging Africa Infrastructure Fund (EAIF)) and output-based grants from the UK Technical Assistance Facility (TAF).[34] The Serena Hotel Project was partially funded by a loan (OOF) from AfDB.

33 See *New Vision*, 2 July 2015, 'MPs pass Partnership Bill'.

34 TAF, Guarantco and EAIF are all subsidiaries of PIDG.

4 Government priorities

4.1 Development priorities

The Government of Uganda's development priorities are set out every five years in its National Development Plan (NDP). The NDP is accepted by development partners as the basis for prioritising external development assistance to Uganda. The aim of the first NDP (2010/11-2014/15) was to address structural bottlenecks in the economy to accelerate socioeconomic transformation, with the aim of Uganda becoming a middle-income country. NDP I established four priority investment areas: physical infrastructure (energy, railways, waterways and air transport); human resource development; access to and availability of critical inputs in agriculture and production; and promotion of science, technology and innovation.

NDP I identified 15 'core national projects' to accelerate progress across these four areas. The largest investments among these core projects included the Karuma, Isimba and Ayago hydropower plants, the oil refinery, the oil pipeline, the Standard Gauge Railway, and iron ore and phosphate development. Other investments included those in Greater Kampala transport infrastructure, irrigation schemes, regional science parks, IT business parks and technical and vocational education. In total, the 15 core national projects were estimated to cost 13.6 trillion Ugandan shillings (equivalent to approximately \$6.7bn at the time) over five years, of which 60% (approximately \$4bn) was expected to be private-sector financed.

NDP I identified four main sources of financing for its implementation: domestic revenue, PPPs, access to capital markets (including issuing sovereign bonds), and external resources (grants and loans) from development partners. While NDP I expected PPPs and sovereign bonds to constitute a major form of financing, it acknowledged that the Government of Uganda would continue to require external development finance in the short to medium term, as it strengthened its domestic revenue mobilisation and anticipated the onset of oil revenues.

NDP II (2015/16-2019/20) anticipates that Uganda will become a middle-income country by 2020. It continues the overall approach of NDP I, while acknowledging that a number of challenges limited its effective implementation. NDP II states that implementation of core projects under NDP I was delayed by: inadequate technical capacity in government to prepare and implement such projects, delays in mobilising project financing, procurement delays, absence of adequate institutional and/or legal frameworks, and limited prioritisiation and poor sequencing of interventions.

NDP II also reports that NDP I was 'severely compromised' by inadequate financing, due to slow progress in domestic revenue mobilisation, declining external assistance and the lack of development of new, innovative development-financing instruments, such as infrastructure bonds, due to delays in finalising the legal framework governing PPPs.

NDP II adjusts its financing strategy to take into account the challenges encountered in mobilising financing during NDP I. In particular, NDP II replaces NDP I's emphasis on the private sector as a major source of public infrastructure financing, and instead outlines a strategy of fiscal expansion for frontloading infrastructure investments, financed by a mix of concessional and non-concessional external loans. This shift can in part be linked to the increasing availability of infrastructure lending from China, coupled with the Government of Uganda's decision not to enter into sovereign bonds in the immediate future, as well as political frustration with the length of time it can take to structure infrastructure investments involving PPPs. Although the NDP acknowledges the risks associated with increased borrowing on non-concessional terms, it believes there is sufficient scope for new borrowing given Uganda's relatively low level of existing public debt, and does not expect macroeconomic stability to be undermined.

NDP II identifies more than 14 'key infrastructure projects' which are expected to cost \$8.1bn over five years, of which \$6.5bn (80%) is expected to come from non-concessional borrowing. Many of these are continuations of the core projects identified in NDP I, including the Karuma, Isimba and Ayago hydropower plants (although the latter is not scheduled to commence until 2020/21), the oil refinery, the oil pipeline and the Standard Gauge Railway. In some cases, the sources of financing for these projects has changed. For example, NDP I anticipated that the three hydropower plants would be financed through a mix of public and private investments, whereas NDP II expects them to be financed through public debt. Other key infrastructure projects identified in NDP II include the Kampala–Jinja and Kampala–Mpigi expressways, rehabilitation of Entebbe Airport, investment in power-grid extension and transmission lines, other parts of the road network and other oil-related infrastructure. Beyond these 14 key infrastructure projects, NDP II also has a broader list of 'core projects', which includes interventions in agriculture, tourism, minerals, skills development and the rehabilitation of general hospitals. The anticipated costs and sources of financing for these additional projects are not specified.

4.2 Partnership principles

The Government of Uganda's partnership principles with development partners were first articulated in 2000, as a part of the Poverty Eradication Action Plan. These principles required development partners to align their assistance with government priorities, by basing their support on the priorities identified in sector plans and harmonising with sector coordination mechanisms. The principles stated the Government of Uganda's preference for untied sector budget support over stand-alone projects, and for joint working among development partners. The principles were updated in 2003, to reflect the government's preference for general budget support over sector budget support.

The partnership principles provided the basis for development partners' assistance in the decade that followed, and were operationalised through mechanisms such as the Uganda Joint Assistance Strategy, which coordinated policy-based dialogue between the Government of Uganda and its budget support partners. NDP I committed to update the principles to reflect policy developments in the decade since they were developed, while continuing their overall approach. NDP I expressed a preference for budget support over project support or vertical funds, and emphasised the importance of donor alignment. However, work on developing the Partnership Policy was interrupted by a corruption scandal in the Prime Minister's Office, which led to the temporary suspension of all budget support in 2012 and, for some donors, all on-budget aid. NDP II does not state any preferences for the provision of external development assistance as such. Instead, it criticises the conditions attached to ODA, and identifies the emergence of the BRICS[35] group of countries as a potential new source of development financing with which Uganda should actively engage.

4.3 Debt management principles

The Government of Uganda's 2013 Debt Management Framework (DMF) provides guidance on the limits, terms and priorities for government borrowing. The DMF limits the net present value of total public debt to 50% of GDP, in line with the East African Community monetary union convergence criteria.[36] The limit on the net present value of external debt to GDP is set at 30%. The DMF states that the Government of Uganda will continue to pursue concessional loans as the preferred means of meeting its external financing requirements and that external borrowing will be based on the following principles:

- It will be primarily focused on productive sectors and those interventions that will enhance productivity.
- Some borrowing, on highly concessional terms, will continue to be sought for social services projects/ programmes to help meet government objectives for social services delivery.
- Non-concessional borrowing will be considered for financing only projects that provide an economic rate of return greater than the interest rate charged.
- Any highly non-concessional loans, such as a Eurobond, will be issued to finance only projects that provide a higher economic return than the interest rate on the loan and which also enable the Government of Uganda to generate a sufficient fiscal return to meet the cost of the loan. The government will primarily consider a Eurobond when large multilateral and/or bilateral financing is not available.
- The minimum amount for any external borrowing shall be $5m, in order to minimise the costs related to contracting the loan.

The DMF identifies the terms associated with the different levels of concessionality, as follows.

- Loans for social service delivery and development must be **highly concessional**, i.e. IDA-comparable or with better terms (40-year maturity, 10-year grace period, 0.75% interest) or with a grant element of not less than 50%.
- Loans for projects intended to enhance productivity but on **less concessional** terms must provide terms with a minimum of 23-year maturity, a 6-year grace period and an interest rate of not more than 2% per annum, or a grant element of not less than 35%.
- **Non-concessional** loans must provide a grant element of not less than 25%, and the project being financed should start generating revenues for government within a period of not more than five years.

The DMF allows contractor-facilitated financing as an option for mobilising external financing, where the Government of Uganda allows contractors to facilitate the process of sourcing the financing required to undertake projects from financial institutions. In this case, the DMF says that contractors will be required to submit bids (technical and financial) to government, and the best bidder is selected not only on technical competences, but also according to who offers the most acceptable terms of financing.

The DMF also recognises PPPs as a mechanism for accessing private-sector finance and management expertise to provide services and related assets that would traditionally have been financed and operated by the public

35 Brazil, Russia, India, China and South Africa.

36 This threshold is also consistent with the threshold set for strong policy performers in the IMF/World Bank framework for debt sustainability analysis – until 2015, Uganda was classified as a strong policy performer, based on its performance against the World Bank's Country Policy and Institutional Assessment (CPIA) index. However, in 2015, Uganda was downgraded to a medium policy performer based on its CPIA scores, meaning that the IMF and World Bank now assess its debt sustainability threshold in net present value terms at 40% of GDP.

sector. However, it notes that PPPs can be very complex and the fiscal risk for government can be difficult to measure and monitor. The Government of Uganda's preference is to enter into PPPs that do not incorporate public guarantees into the contracts. However, in the event that they are included, the Government of Uganda will clearly identify, calculate and disclose them. The same principle applies to the costs and risks of contingent liabilities.

4.4 Priorities at sector level: energy sector

The NDP anticipates a range of financing sources for infrastructure priorities, while the DMF specifies the terms on which debt can be contracted. However, these high-level policies have not systematically translated into structured financing policies at sectoral level. Sectors have not generally developed a strategy that targets different types of financing according to the intervention to be funded, and tend to be reactive to the financing offers that are made to them.

However, in the energy sector a distinct sectoral policy on how different forms of financing should support sector objectives has emerged and evolved over time. Financing to support the provision of 'traditional' public goods, such as transmission lines, distribution networks and rural electrification, is required to be either highly concessional or less concessional. Non-concessional financing is only used for large-scale infrastructure investments with a high economic rate of return, such as power generation.

The energy sector has used PPPs to finance power generation. The 250 MW Bujagali hydropower dam (see Box 6), which was commissioned in 2006, was financed through a PPP arrangement, underpinned by a power purchasing agreement between the independent power producer and the Uganda Electricity Transmission Company Ltd, and supported by a government-backed partial risk guarantee from the World Bank (IDA). The partial risk guarantee improved the terms on which private financiers were willing to extend project financing to the independent power producer. Investment in transmission lines for power evacuation from Bujagali was financed by the Government of Uganda, using highly concessional financing from AfDB and Japan. Since the Bujagali project, the power sector has developed a number of other smaller generation projects using PPPs for generation capacity and supported by the Government of Uganda financing for transmission infrastructure.

However, changes in energy-sector priorities have affected the financing of the next generation of large hydropower dams – Karuma (600 MW), Isimba (183 MW) and Ayago (840 MW). The Government of Uganda initially launched a tender for Karuma in the expectation that it would be a government-implemented investment, financed through a sovereign bond. However, mid-way through, and given that the leading firms were Chinese, a decision was taken to seek Chinese financing instead, on the basis that it would be cheaper. Eventually, Chinese financing was secured for both Karuma and Isimba, and the contracts were awarded to the top two firms in the original Karuma tender. Construction of Ayago is not expected to commence until 2020, and financing for it has not yet been secured.

There are a number of reasons for the energy sector's decision not to pursue PPP financing for the next generation of large hydropower dams. First, private capital, which has no grace period and relatively short repayment periods, unless supported by a government guarantee, is considered by the Ministry of Energy to be expensive, with knock-on effects for the cost of the tariff. The Ministry of Energy is of the view that Chinese financing for Karuma and Isimba will yield lower tariffs than Bujagali (even though 45% of the China Exim Bank loan for Karuma will be on commercial terms). Second, the Ministry considers accessing Chinese financing to be a faster option than PPP negotiation: it took four years to structure the Bujagali PPP, but only two years to bring Karuma to a close. Politically, speed appears to be an important attribute for project financing modalities. However, some interviewees noted that Chinese financing brings with it restrictions on procurement and the potential for reduced transparency, compared with a competitive PPP process, and some questioned whether the Government of Uganda has the technical capacity to oversee the construction of a large hydropower facility. In addition, some domestic commentators have questioned the Ministry of Energy's view that Chinese financing will yield cheaper power tariffs[37] than the Bujagali PPP.

At the same time, the energy sector is continuing to pursue PPP financing for the oil refinery, which is estimated in NDP II to cost $535m. Norway provided support to the Government of Uganda to hire a UK firm to undertake the feasibility study for the refinery, and a US firm to act as the transaction adviser for selection of the lead investor. A Russian firm has emerged as the preferred bidder, and the deal is not expected to require the provision of government guarantees. A PPP may also be developed for the provision of electricity to two districts in the Albertine Rift oil region, using flare-off gas from oil production. The Government of Uganda is in discussions with the same investor leading the multi-sector PPP in Kalangala, and the UK government is potentially interested in providing backing.

37 See article by Andrew Mwenda, *Daily Monitor*, 17 May 2015.

5 Arenas of negotiation

This section describes the main arenas in which the Government of Uganda seeks to engage with different providers of development assistance. The focus is on arenas related to in-country aid coordination (e.g. sectoral or technical working groups, regular high-level donor–government meetings), as these are often key fora in which donors and government engage in discussing sectoral strategies, project identification, policy dialogue and conditionalities. We also review the extent to which providers of development finance beyond ODA (notably non-DAC donors) participate in these arenas.

Overall responsibility for aid management rests with the MFPED. The Minister of Finance has sole authority to enter into loans and guarantees on behalf of the Government of Uganda, and is also mandated to receive all grants from foreign governments, international organisations and any other person. The ministry has a dedicated department, the Department for Development Assistance and Regional Co-operation (DARC), responsible for liaising with providers of development assistance and negotiating terms in line with the Government of Uganda's priorities. The Department of Debt Management supports the DARC by assessing the concessionality of proposed loan terms in line with the conditions set out in the DMF.

Each line ministry has a department responsible for planning. The planning department is responsible for developing sector strategies that identify the priorities against which external assistance is sought. Planning departments are responsible for coordinating with donors at sectoral level, and take a lead in negotiating proposed support from external providers, ensuring that it is in line with sector priorities and does not duplicate existing efforts. Planning departments also support the operation of the line ministry's sector working group, which acts as a forum for dialogue and agreement on sector strategy between the line ministry and a number of its development partners. Sector working groups often conduct annual sector reviews, to review the extent to which the sector is implementing its priorities as planned. The outcomes of these reviews often form the basis for future development assistance from participating donor members.

All proposals for development assistance that are negotiated between line ministries and development partners are forwarded to MFPED for approval. MFPED, through the DARC, assesses the viability of the proposal against a range of criteria, including its consistency with the priorities established in the NDP, its consistency with the Government of Uganda's requirements for public financial management, and its compatibility with the DMF and with the Government of Uganda's macroeconomic targets. These targets include the fiscal deficit excluding grants, limits on the overall debt stock as a percentage of GDP as set out in the DMF, and limits on new non-concessional borrowing, as agreed with the IMF in the PSI programme.

Once MFPED is satisfied with the viability of the proposal, the line ministry is given the go-ahead to submit it to the Development Committee, which is chaired by MFPED. Once the proposal is approved by the committee, it is incorporated in the Public Investment Plan. Grant-financed agreements are signed by the Minister of Finance, while loan-financed agreements are submitted through Cabinet to Parliament for approval. A loan may be deemed effective and captured in the annual budget only once it has been approved by Parliament.

MPFED often finds it much harder to exert control over negotiation processes involving contractor-facilitated financing, compared with negotiations with sovereign bilateral and multilateral providers. This particularly applies to discussions between line ministries and Chinese contractors, with a view to securing eventual infrastructure financing from China Exim Bank. These processes do not follow the procedures for contractor-facilitated financing set out in the DMF. They often do not involve competitive tendering, and MFPED is usually brought fully into the picture only once an initial agreement has been reached between the line ministry and the contractor. This late-stage involvement puts MFPED in a difficult position, particularly if political momentum has built up around the proposed project, yet the proposed volumes of financing are not compatible with macroeconomic, borrowing or debt targets. For example, initial proposals by the Ministry of Works for the Standard Gauge Railway were based on discussions with two separate Chinese contractors. These proposals exceeded \$10bn, which was far in excess of what MFPED could accommodate while meeting its IMF and debt-sustainability targets. Eventually, MFPED was able to secure agreement with the Ministry of Works, and at a political level, that the works would be carried out in phases, with the first phase (incorporated in NDP II) not exceeding \$3bn.

The increasing proportion of bilateral ODA funding channelled direct to non-government providers without passing through government also poses a coordination challenge to MFPED. In these cases, MFPED is able to influence the allocations at a fairly high level only through discussions on the relevant donor's country strategy. The individual projects are not submitted to the Development

Committee for review and not incorporated in the Public Investment Plan. However, in some cases, at sectoral level, the line ministry may engage with the bilateral donor and have some discussion on project details.

At an overall level, OECD-DAC and multilateral donors with in-country presence coordinate among themselves through the Local Development Partners Group. NDP I requested that all donors participate in this group, to provide a single point of contact between the Government of Uganda and its partners. The World Bank, as chair of the Local Development Partners Group during the NDP I period, made efforts to involve China through its embassy in Kampala. However, the embassy has to date declined to attend, stating that it prefers to conduct its relations bilaterally.

The recently established National Partnership Forum (NPF), chaired by the Prime Minister, is the apex body for dialogue between the Government of Uganda and its development partners. The NPF replaces the previous apex coordinating mechanism (the Policy Coordinating Committee), which was undermined by the corruption scandal in the Prime Minister's Office in 2012. The NPF is supplemented by policy-oriented working groups between the Government of Uganda and development partners, for example the Public Expenditure Management Committee, chaired by MFPED, and the various sector working groups. These groups are mainly attended by OECD-DAC donors and multilateral institutions, such as the ADB and World Bank, which have in-country representation. Multilateral institutions without permanent representation in-country (e.g. IDB, OPEC Fund, BADEA) are less likely to participate in these coordination mechanisms. Instead, their engagement is usually conducted on a mission-based, bilateral basis. The same applies for smaller DAC donors (e.g. South Korea) and smaller non-DAC donors (e.g. Kuwait, Saudi Arabia). Although China is represented in Uganda through its embassy, it prefers bilateral discussions to participation in multi-stakeholder coordination mechanisms.

MFPED often plays a key role in guiding donors that do not have a strong in-country presence towards particular sectors or particular sector priorities. For example, MFPED, through the minister at the time, played an instrumental role in involving the IDB in the BTVET (business, technical and vocational education and training) subsector, which in turn prompted other Arab donors (OPEC Fund, BADEA, Saudi Fund) to become engaged in supporting BTVET. Likewise, Uganda's missions abroad are also reported to play an active role in introducing interested non-DAC donors to particular sectors. The education sector provides an interesting example of donor-to-donor mobilisation: ADB encouraged South Korea to become involved in BTVET, based on the experience of its post-primary support programme.

Some line ministries find that the non-involvement of key donors in sector coordination mechanisms complicates the overall dialogue, although it is acknowledged that these challenges can be mitigated to some extent by having a strong sector strategy with which to guide bilateral discussions. The Ministry of Energy has made efforts to involve China in the Energy Sector Working Group, and reports that its representatives attend on an infrequent basis. The Ministry of Education has established a specific coordination team for Arab providers of development finance within BTVET.

The Government of Uganda coordinates with donors and civil society organisations on climate-change issues through a technical working group established as a subgroup to the Water and Environment Sector Working Group. The subgroup has helped provide inputs to the development of the Government of Uganda's Climate Change Policy, which has recently been approved by Cabinet, and also discusses issues such as actor mapping within the sector. Donors also have their own climate change coordination group.

The Government of Uganda does not have any formal mechanism for coordinating with providers of development finance who work directly with the private sector or civil society, such as philanthropic foundations. MFPED does not have an overview of their flows, even though philanthropic foundations such as the Gates and MasterCard Foundations sometimes work closely with OECD-DAC donors, for example in financing for private-sector development. Some pockets of information may exist about direct philanthropic support at sectoral level (one interviewee gave an example of support for biogas capture in a Kampala primary school, supported by the Gates Foundation), but there are no reports of philanthropic providers participating in government-led sector working groups.

6 Negotiation outcomes

The era of substantial budget support provision in Uganda has passed, even though nominally it remains the government's preferred modality of support. Budget support fell significantly as a share of total on-budget aid between 2007 and 2011, from over 40% to less than 15%. This was largely driven by governance concerns among OECD-DAC donors, although it was also in keeping with a general decline in budget support provision as a share of ODA financing in many low-income countries. Budget support to Uganda was then temporarily suspended in its entirety in 2012, following a corruption scandal in the Prime Minister's Office, and now accounts for less than 5% of on-budget aid.[38]

Despite OECD-DAC donors' continuing concerns about governance, a number of other factors help support Uganda's negotiating position with development finance providers. Uganda has a strong track record of economic growth and poverty reduction, and a clear vision of its investment priorities over the next five years, particularly related to infrastructure. It is not short of financing 'offers'. Its flows from OECD-DAC donors and multilateral institutions remain fairly substantial in nominal terms. OECD-DAC donors and multilateral institutions are also demonstrating their willingness to innovate in their provision of development finance, particularly in supporting instruments that enable private-sector financing for the provision of public goods, and blending their loan financing for infrastructure investments so that its concessionality remains acceptable to the Government of Uganda. In addition, Uganda has started to access funding from China for large-scale infrastructure, and plans to access considerably higher levels of funding from non-DAC donors in the next 10 years.

The relative strength of Uganda's negotiating position is evidenced by its decision not to enter into sovereign bonds for the foreseeable future.[39] Although sovereign bonds are recognised as a potential source of financing in NDP I, NDP II and the DMF, the Government of Uganda has taken a policy decision not to pursue them at present. There are two main reasons for this. First, MFPED recognises that sovereign bonds are expensive, and is concerned that public debt could rise to unsustainable levels during currency depreciation, increasing bond yields. Second, MFPED is aware of the repayments risks associated with sovereign bond financing in the event that projects are not well designed or face delays in implementation. Given that the Government of Uganda continues to face capacity challenges with respect to appropriate project design and timely implementation, as evidenced by its high stock of undisbursed loan commitments, MFPED believes that the risks involved in sovereign bond financing would be too high at present. Its preference therefore is to access less costly and/or risky development financing options, including non-concessional loans from non-DAC bilateral donors, for as long as they are available. MFPED's clear policy stance on sovereign bonds is reported by senior officials to have helped reduce unsolicited pressure and offers from international commercial finance institutions.

The Government of Uganda has secured, or is in the process of securing, financing for a number of the priority infrastructure projects set out in NDP I/II, and is not compelled to accept financing for investments inconsistent with its development priorities. Its project negotiation process involves both line ministries and MFPED. Sectors are able to guide development finance providers towards their priorities at a sectoral level, and MFPED also cross-checks for consistency with the NDP. Loan financing has the additional check of requiring approval by Parliament. The Parliamentary Committee on the National Economy takes the lead in scrutinising all loan proposals, and is reported to be active in its role, referring back proposed loans when further details are needed on either the nature of the activity or the cost. The major challenge faced by MFPED is the scope for divergence in opinion between political and technical actors within the Government of Uganda about what constitutes a development priority. In this case, MFPED and the relevant line ministry may not be in a position to resist political pressure to accept financing. In addition, they have limited or no influence over external financing that flows direct to the non-government sector.

The Government of Uganda is capable of assessing whether the loan terms being offered are consistent with the DMF. Where the terms are not consistent, MFPED has the capacity to negotiate with providers to revise them, or to request a blended approach to project financing across providers, to enable the overall terms to remain compatible with the DMF. Blending is an increasing feature of project financing provided by OECD-DAC donors, particularly for infrastructure in the water and power sectors.

38 Budget support estimates in the 2015/16 budget amount to Shs 44bn compared to Shs 994bn of project support.

39 See *Financial Times*, 1 September 2014, 'Uganda says 'no' to sovereign bonds'.

However, the Government of Uganda is not consistently adhering to the concessionality criteria established in the DMF. The DMF states that loans for social-service delivery and development must be on highly concessional terms. However, there are several examples of loans for education (BTVET) and health (Mulago and other hospitals) being contracted from lenders on terms that qualify as less concessional, non-concessional or even highly non-concessional according to the DMF criteria. (Annex 2 assesses the concessionality of creditor terms as per the DMF thresholds.) This particularly applies to borrowings from OPEC Fund (whose terms qualify as non-concessional), Kuwait Fund (whose terms are less concessional), Saudi Fund (also less concessional), BADEA (either less concessional or non-concessional) and IDB (whose more stringent terms qualify as highly non-concessional). The Government of Uganda interviewees cited the limited availability of highly concessional financing as a reason for contracting social-sector loans on terms that are not consistent with the DMF. The implication is that the interventions being funded on less favourable terms are considered sufficiently urgent from a political and/or policy perspective to necessitate more expensive financing.

Political priorities take precedence over the DMF principles. For example, subject to parliamentary approval, the Government of Uganda is about to take on two fully commercial loans tied to specific contractors from the UK (through ECGD) and Japan (through JBIC), for roads in the oil region and road-maintenance equipment respectively. During the interviews, the justification provided for entering into these borrowings on commercial terms was that the interventions were needed urgently; as a result, government did not have time to source less costly financing alternatives consistent with the DMF and procure a contractor on a competitive basis.

Political preferences are an influential factor in the choices made between types of financing and project approach – particularly when it comes to large-scale economic investments that could be financed through either non-concessional government borrowing or PPPs. These preferences place a premium on speed of financing and limited conditionalities, and therefore are inclined towards non-concessional borrowing from China, which can be arranged more rapidly than a PPP, and is accompanied by few or no conditionalities .

The DMF's provisions on contractor-facilitated financing are rarely adhered to. The process for selecting a contractor and sourcing financing for the oil refinery has followed the technically led, competitive approach set out in the DMF. However, in a number of other cases discussions have been carried out bilaterally with Chinese contractors, on the assumption of securing financing from China Exim Bank. Such cases are reported to include the National ICT backbone project, the Kampala–Entebbe expressway, the Standard Gauge Railway and, to some extent, the tendering of the Karuma and Isimba hydropower plants. (Karuma followed a competitive process but, once China Exim Bank financing was confirmed, the second-placed contractor in the Karuma process was awarded the contract for Isimba without any further procurement process.) However, MFPED is making efforts to ensure that the next generation of road PPPs (Kampala–Jinja expressway and Southern Bypass, Kampala–Mpigi expressway) follow a more transparent and competitive process consistent with the DMF.

Local discourse on the concessionality of loans from China Exim Bank tends to overstate Uganda's negotiation outcomes with China. During the interviews, large-scale infrastructure lending from China Exim Bank (e.g. the Karuma hydropower dam) was frequently referred to as being on a mix of 'concessional and non-concessional' terms. NDP II refers to lending from China Exim Bank as being 'semi-concessional', a term that does not exist in the DMF. However, in terms of the DMF criteria, China Exim Bank terms[40] are either highly non-concessional (i.e. provide a grant element of less than 25%) or commercial.

The DMF does not preclude borrowing on commercial terms, but requires the relevant investment to provide a higher economic return than the interest rate on the loan, and to enable the Government of Uganda to generate a sufficient fiscal return to meet the cost of the loan. The Government of Uganda does not appear to be conducting such analysis before entering into commercial financing agreements with China Exim Bank, or any other commercial loan providers. This raises the risk that project-related revenues may be insufficient to support future debt servicing. Such analysis also needs to fully take into account future maintenance costs. Lack of recurrent government funding for maintenance of road infrastructure was cited as a major concern during the interviews.

Sectors complain of the time it can take to develop projects using financing from OECD-DAC donors and multilateral institutions, and in some cases even non-DAC donors (excluding China). As noted, the risk of delays influences the prioritisation or selection of funding sources for politically important projects.

The Government of Uganda faces capacity constraints to achieving successful negotiation outcomes in line with its priorities. The Government of Uganda's capacity for project design, preparation and implementation is weak, as evidenced by its relatively low rate of utilisation of existing debt. Line ministries are reported on occasion to have entered into project negotiations without having conducted full feasibility studies (e.g. for the Standard Gauge Railway), and the Government of Uganda has limited experience in managing some of

40 See MFPED (2014) and Annex 4 for details.

the project-financing arrangements involved (e.g. the Kampala–Entebbe expressway). These weaknesses increase the chances of poor value for money and poor project outcomes, particularly for financing delivered through a contractor-facilitated approach or PPPs. Internal capacity challenges are also a factor in the delay in direct access to climate financing, in terms of meeting the required accreditation criteria.

Box 7: Future levels of public indebtedness

Uganda's public indebtedness is set to increase over the next five years, due to the scale of the infrastructure priorities set out in NDP II and the reliance on public-sector investment to finance them. The IMF (2015) estimates that the total impact on external debt will be about 14 per cent of GDP. It considers Uganda to have scope to increase borrowing to finance new infrastructure investment given its current low level of external indebtedness, with a low risk of creating debt distress.

NDP II estimates indicate that the ratio of net present value (NPV) of debt to GDP will reach 40% in 2018/19. By contrast, MFPED (2015a) states that the present value of debt to GDP will be 27.5% in 2019/20. However, it says the present value of debt to GDP could reach 43% in 2019/20 if Uganda were to borrow largely on highly non-concessional terms.

While these projected levels of debt remain within the government's desired threshold of 50%, the estimates have been assisted by the recent GDP rebase, which raised the nominal value of GDP in 2013/14 by 13.1%. Without this, the NPV of debt to GDP would be nearer to 50% by 2020.[*]

Note: [*]Authors' calculations based on data provided by MFPED.

7 Conclusions

The development financing landscape in Uganda is on the point of shifting significantly, from a situation of ODA-dependent financing to a much more diverse picture involving much higher levels of non-ODA flows. These flows are primarily from China, but also include non-concessional assistance from multilateral institutions, such as AfDB and IDB, as well as contractor-specific commercial loans from OECD-DAC donors. OECD-DAC donors are actively blending their grant and loan financing, particularly in the energy and water sectors, to maintain its concessionality and are providing instruments that help leverage private investment for the delivery of public infrastructure.

The Government of Uganda is not short of financing 'offers' and is not compelled by external providers to take on financing that is not aligned with its priorities or where the terms are not compatible with its DMF. However, domestic political imperatives, particularly the premium placed on rapid project implementation, mean that it is does not always adhere to its own DMF criteria. This raises the risk that financing can become supply-driven by default, with modalities and approaches being adopted based on what is being offered, because they appear to offer the prospect of being fast, even though technically other approaches may offer better value for money or have less impact on public indebtedness.

Infrastructure is the Government of Uganda's biggest priority, particularly in the energy and transport sectors (roads, rail and air). Its current financing options for large-scale infrastructure are primarily Chinese loans and PPPs, since it has taken a decision not to issue sovereign bonds for the time being. OECD-DAC donors and multilateral institutions do not individually provide direct grant and loan financing in the volumes required to fund these large-scale infrastructure projects as government projects. Although OECD-DAC donors have already started working consortiums to finance small to medium-scale infrastructure, they are yet to do so for large-scale infrastructure, where their preference is to facilitate PPPs.

Access to Chinese financing has considerably increased the Government of Uganda's ability to embark on priority infrastructure investments in the past few years. Politically, Chinese loans are considered preferable to PPPs for large-scale infrastructure investments because they are faster and deemed to deliver a lower cost for end-users, even though they have a significant impact on public indebtedness. Scope remains for the Government of Uganda to develop PPPs for projects where there is less immediate political pressure for visible results and/or donor support to structuring the PPP arrangements. However, the Government of Uganda, including MFPED, continues to have significant capacity gaps when it comes to innovative project structuring and developing PPPs. Government capacity gaps in project design and management are a contributing factor in its decision not to seek financing through sovereign bonds at present.

The entry of China as a major player in Uganda's development financing landscape has led to some fragmentation in country-level dialogue. China, as a matter of policy, does not engage in multilateral coordination mechanisms in-country. China's growing presence is also considered by some stakeholders to have enabled the Government of Uganda to pay less attention to the governance concerns of OECD-DAC donors.

The approach to negotiating Chinese financing tends to differ from those used for other forms of financing, as it is generally contractor-led, and often sole-sourced. Chinese funding is sourced and approved after a Chinese contractor has come to an agreement with government. This approach raises concerns relating to value for money, since the Government of Uganda has not always conducted full project feasibility studies before entering into negotiations with Chinese contractors, and has limited experience in managing some of the project financing arrangements involved. The contractor-led approach makes it harder for MFPED to exercise control over aggregate spending and debt targets, as line ministries, with political support, may enter into memorandums of understanding with contractors for key NDP projects without reference to the macro-fiscal implications.

Uganda's debt is currently sustainable and is expected to remain so in the medium term, despite increasing concerns over future unsustainability. the Government of Uganda intends to borrow to construct three major dams and the Standard Gauge Railway in the next five years. The sustainability of these borrowings is highly sensitive to the loan terms. Other risk factors to future sustainability and ability to repay include the recent fall in oil prices (reducing the anticipated future revenues from oil), the continuing balance of payments deficit and Uganda's poor track record in project design, implementation and management, as well as maintenance.

The Government of Uganda's investment pipeline is guided by the priorities established in the NDP. The NDP states that the selected infrastructure projects will add 0.3-0.4 percentage points to GDP once completed. However, a number of stakeholders expressed concerns that the NDP does not pay sufficient attention to sequencing interventions to maximise their efficiency and absorptive capacity (a major challenge), or to their potential to contribute to balanced growth. In addition, the NDP does not provide a technical rationale for selecting public debt over private capital to finance some of these major infrastructure investments, and there is no reflection on the opportunity cost of using large amounts of public debt to finance investments that could otherwise attract private-sector capital. In the absence of sound technical underpinnings, the risks of lower than anticipated economic growth and future debt unsustainability will increase.

7.1 Recommendations

To address some of these challenges, and to derive maximum benefit and value for money from the opportunities provided by the diversification of the development financing landscape in Uganda, this case study offers the following recommendations to the Government of Uganda, and particularly MFPED.

- Work with the National Planning Authority and relevant line ministries to develop a robust framework to guide the selection of financing modalities for large-scale infrastructure projects identified in the NDP, looking at the alternatives of public debt or private capital.
- Review the DMF to assess the continuing validity of its provisions and then adhere to it in routine loan contracting.
- Supplement the existing DMF by developing a strategy that guides the modalities and sources of financing on a sector-by-sector basis in support of the sectoral priorities established in the NDP.
- Invest significantly in the Government of Uganda's capacity to analyse potential projects in terms of their rates of return, fiscal impact and contribution to balanced growth, to guide the selection and sequencing of key projects in the NDP, as well as to ensure adherence to the DMF provisions for non-concessional borrowing and contractor-facilitated financing.
- Establish what constitutes an acceptable rate of economic return for projects based on past long-term performance in the sector (including assumptions on maintenance).
- Require full project feasibility studies to be conducted before line ministries can enter into negotiations with development finance providers or contractors. Establish a dedicated financing source for feasibility studies if necessary.
- Invest significantly in the Government of Uganda's capacity, and the capacity of key line ministries, to structure projects that involve private-sector financing, including PPPs and sovereign bonds.
- Explore with OECD-DAC donors and multilateral development institutions the options and opportunities for using their financing to fund feasibility studies on a systematic basis, to build government capacity for project design, analysis and financial structuring, and to leverage large-scale infrastructure investments.
- Explore with OECD-DAC donors options to rebalance their support towards infrastructure, setting a clear timetable for achieving an agreed share.
- Explore the opportunities to access multilateral climate funds to finance green infrastructure financing, once accreditation is attained.
- Request China, through its embassy, to participate in country-level dialogue with other development partners. Given the increasingly significant role that China is playing in development financing in Uganda, this is important for both governance and coordination.
- Bring the management of Chinese financing into established aid coordination mechanisms within MFPED.

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Annexes

Annex 1: Approved, pending and pipeline projects (2014/15-2024/25) at June 2015

Project	Donor	Loan/grant	Type	$m	Status
Financial inclusion in rural areas	IFAD	Loan	ODA	28.200	Approved 2014/15
Kampala institutional and infrastructure development	IDA	Loan	ODA	175.000	Approved 2014/15
North-eastern road corridor asset management	IDA	Loan	ODA	243.800	Approved 2014/15
Energy for rural transformation (ERT 2)	IDA	Loan	ODA	12.000	Approved 2014/15
Kayunga and Yumbe general hospitals	SFD/BADEA/OFID	Loan	Non-ODA	37.000	Approved 2014/15
Karuma hydropower and transmission lines	China Exim Bank	Loan	Non-ODA	645.821	Approved 2014/15
Karuma hydropower and transmission lines	China Exim Bank	Loan	Non-ODA	789.337	Approved 2014/15
Isimba hydropower project and interconnection	China Exim Bank	Loan	Non-ODA	482.578	Approved 2014/15
Kabale–Mirama Hills transmission line	IDB	Loan	ODA	83.750	Approved 2014/15
Muyembe–Nakapiripriti road upgrade	IDB	Loan	ODA	110.000	Approved 2014/15
Road sector support	ADF	Loan	ODA	107.465	Approved 2014/15
E-procurement	IDA	Grant	ODA	0.500	Approved 2014/15
Financial management and accountability programme	Germany	Grant	ODA	14.612	Approved 2014/15
Increasing SME leasing financing	IDA	Grant	ODA	0.107	Approved 2014/15
Transparency and accountability of public contracting	IDA	Grant	ODA	0.650	Approved 2014/15
Control and management of public resources	Denmark	Grant	ODA	2.337	Approved 2014/15
Improving primary teacher and school effectiveness	IDA	Grant	ODA	100.000	Approved 2014/15
Queensway substation improvements	Japan	Grant	ODA	21.275	Approved 2014/15
Strengthening health local service delivery	Belgium	Grant	ODA	11.004	Approved 2014/15
Access to skilled care during pregnancy and delivery	IDA	Grant	ODA	13.300	Approved 2014/15
Agriculture cooperative capacity building in ICT	IDB	Grant	ODA	0.140	Approved 2014/15
Planning capacity building for NDP II	IDA	Grant	ODA	0.317	Approved 2014/15
Support to fishing communities in Buikwe District	Iceland	Grant	ODA	7.000	Approved 2014/15
Training in the development of PPPs in Uganda	BADEA	Grant	ODA	0.150	Approved 2014/15
Water and sanitation service in Kampala for urban poor	Germany	Grant	ODA	12.424	Approved 2014/15
Water and sanitation services in north-eastern Uganda	Germany	Grant	ODA	12.424	Approved 2014/15
Albertine Region sustainable development project	IDA	Loan	ODA	145.000	Pending approval
Regional pastoral livelihoods resilience project	IDA	Loan	ODA	40.000	Pending approval
Markets and agricultural trade improvement programme	ADB	Loan	ODA	120.000	Pending approval
Restoration of livelihoods in the Northern Region programme	IFAD/ASAP	Loan	ODA	50.200	Pending approval
Entebbe international airport upgrade and expansion	China Exim Bank	Loan	Non-ODA	325.000	Pending approval
Tertiary education in biomedical sciences	AfDB	Loan	ODA	30.000	Pending approval
Earth-moving equipment	JBIC	Loan	Non-ODA	131.750	Pending approval
Defence equipment	China Exim Bank	Loan	Non-ODA	107.000	Pending approval
Greater Kampala flyover and road upgrading	Japan	Loan	ODA	199.000	Pending approval
Muzizi hydropower	KfW/AFD	Loan	ODA	101.128	Pending approval
Oil project road infrastructure – Karugutu–Ntoroko; Kabwoya–Buhuka	UK/SCB	Loan	Non-ODA	154.415	Pending approval
Rural electrification grid extension	AFD	Loan	ODA	55.100	Pending approval
Industrial parks power transmission and substations	China Exim Bank	Loan	Non-ODA	94.978	Pending approval
Rural electrification project phase 2	BADEA	Loan	ODA	63.000	Pipeline
Rural electrification in three service territories	OPEC Fund	Loan	ODA	51.400	Pipeline

Annex 1: Approved, pending and pipeline projects (2014/15-2024/25) at June 2015 (continued)

East African Lake Victoria maritime communication project	AfDB	Loan	ODA	6.000	Pipeline
Energy for rural transformation	World Bank	Loan	ODA	100.000	Pipeline
Northern power transmission	World Bank	Loan	ODA	100.000	Pipeline
Muyembe–Nakapiripirit road	IsDB	Loan	ODA	67.000	Pipeline
Luwero–Butalangu road	BADEA	Loan	ODA	32.000	Pipeline
Skills development	World Bank	Loan	ODA	100.000	Pipeline
First pension reform policy credit	World Bank	Loan	ODA	50.000	Pipeline
Upgrading of Katine–Ochero road project	IDB	Loan	ODA	45.000	Pipeline
Kumi Serere–Soroti road	IDB	Loan	ODA	67.000	Pipeline
Agriculture cluster development	World Bank	Loan	ODA	100.000	Pipeline
Post-primary education training 2	World Bank	Loan	ODA	75.000	Pipeline
Uganda safety net programme	World Bank	Loan	ODA	100.000	Pipeline
Uhuru hydropower dam project	Exim Bank of India	Loan	Non-ODA	45.000	Pipeline
Small towns water and sanitation programme (sector budget support)	AfDB	Loan	ODA	80.000	Pipeline
Upgrading of Kapchorwa-Suam road	AfDB	Loan	Non-ODA	75.000	Pipeline
Kampala–Mpigi expressway	AfDB	Loan	Non-ODA	300.000	Pipeline
Rwenkunye–Apac–Lira–Kitgum–Musingo road	IDB	Loan	Non-ODA	174.000	Pipeline
Grid extension in northeast, central and Lira service territories including Gulu and upgrading of Mutundwe and Lugogo substations project	AfDB	Loan	Non-ODA	100.000	Pipeline
Masaka–Mbarara transmission line	AfDB	Loan	Non ODA	62.000	Pipeline
Phase 2 of the farm income enhancement and forest conservation project	AfDB	Loan	Non ODA	75.000	Pipeline
Renovation and equipping of 20 selected hospitals and heart institute	IDB	Loan	Non ODA	268.000	Pipeline
The Entebbe airport rehabilitation	Exim Bank of China	Loan	Non-ODA	200.000	Pipeline
Grid extensions and associated reticulation	IDB	Loan	Non-ODA	65.000	Pipeline
Hoima–Kafu 220 kV line	AfDB	Loan	Non-ODA	47.000	Pipeline
Mbale–Bulambuli 132 kV line	TBC	Loan	TBC	48.400	Pipeline
Lira–Gulu Agago 132 kV line	TBC	Loan	TBC	44.000	Pipeline
Ayago–Olwiyo 400 kV transmission line	TBC	Loan	TBC	48.800	Pipeline
Mirama–Kikagati–Nsongezi 132 kV line	TBC	Loan	TBC	42.600	Pipeline
Masaka–Mwanza 220 kV Line	TBC	Loan	TBC	42.100	Pipeline
Nkenda–Mpondwe–Beni 220 kV line	TBC	Loan	TBC	50.400	Pipeline
Olwiyo–Nimule–Juba 400 kV line	TBC	Loan	TBC	76.800	Pipeline
Kawanda–Bombo 132 kV line	TBC	Loan	TBC	28.700	Pipeline
Nalubaale–Lugazi 132 kV line	TBC	Loan	TBC	20.300	Pipeline
Karuma–Tororo 400 kV line	TBC	Loan	TBC	223.000	Pipeline
Substations upgrade	TBC	Loan	TBC	109.300	Pipeline
Standard Gauge Railway	Exim Bank of China	Loan	Non-ODA	3,200.000	Pipeline
Forecast grants 2015/16-2025/26	N/A	Grant	ODA	1,667.000	LTEF

Source: MFPED (2015a).

Annex 2: Concessionality of creditor terms

Creditor	Maturity period (years)	Grace period (years)	Interest rate	Management fees / service charge	Concessionality as per DMF thresholds
IDA	38	6	0.75%		Highly concessional
AfDB	40	10	0.75%		Highly concessional
ADB	20	5	6-month LIBOR + funding cost margin (0.01%) + lending margin (0.6%)		Less concessional
IDB	30	10		0.75%	Highly concessional
	15	4	LIBOR + 155bps	0.75%	Highly non-concessional
IFAD	40	10		0.75%	Highly concessional
BADEA	24	5	2.5%		Non-concessional
	24	5	1.00%		Less concessional
OPEC	20	5	1.25%	1.00%	Non-concessional
France (AFD)	20	5	EURIBOR + margin (0.25% – 6%)		Commercial to less concessional, depending on interest rate
Germany	15	3	4.5%	1.00% lump sum	Commercial
Saudi Fund	30	10	1.00%		Less concessional
Kuwait Fund	40	5	1.50%	0.50%	Less concessional
South Korea	40	15	0.01%	0.10%	Highly concessional
China	30	10	0.01%		Highly concessional
China Exim Bank	20	5	2.00%	1.00%	Highly non-concessional
	15	5	LIBOR + 3.5%	0.50%	Commercial
EIB	15	3	1.00%		Non-concessional
	20	5	1.75%		Non-concessional
IMF	10	5	0.50%		
Japan (JICA)	40	10	0.01%		Highly concessional
Japan (JBIC)	10.5	0.5	CIRR + OECD risk premium		Commercial
Abu Dhabi	20	5	1.5%	0.50%	Non-concessional

Source: MFPED (2015a).

Note: The assessment of concessionality is the authors' own, based on the following DMF thresholds:

- *Highly concessional: grant element of not less than 50%.*
- *Less concessional: grant element of not less than 35%.*
- *Non-concessional: grant element of not less than 25%.*
- *Highly non-concessional: grant element of less than 25% .*
- *Commercial: no grant element.*

Annex 3: Mapping external development finance flows to Uganda, 2002–2013

	Source	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
ODA*	OECD CRS	693.87	958.97	1,224.42	1,228.77	5,146.10	1,616.98	1,622.12	1,736.47	1,716.82	1,590.03	1,679.07	1,802.92	21,016.54
OECD-DAC donors	OECD CRS	388.31	543.86	634.69	635.52	902.56	934.31	997.72	984.62	1,042.17	993.39	948.99	1,047.81	10,053.94
Bilateral grants	OECD CRS	*383.06*	*531.50*	*629.18*	*634.15*	*902.56*	*934.31*	*980.68*	*968.23*	*1,035.73*	*992.23*	*945.70*	*1,027.53*	*9,964.85*
Bilateral loans	OECD CRS	*5.25*	*12.36*	*5.52*	*1.37*			*17.04*	*16.39*	*6.44*	*1.15*	*3.29*	*20.28*	*89.09*
Multilateral donors	OECD CRS	305.56	415.11	589.72	593.25	4,243.54	682.67	624.41	751.85	674.65	596.64	730.08	755.12	10,962.60
Multilateral grants	OECD CRS	*175.75*	*133.68*	*395.31*	*380.40*	*4,001.75*	*253.23*	*384.48*	*310.37*	*246.55*	*265.53*	*379.72*	*229.08*	*7,155.86*
Multilateral loans	OECD CRS	*129.81*	*281.42*	*194.41*	*212.85*	*241.78*	*429.45*	*239.93*	*441.48*	*428.10*	*331.11*	*350.36*	*526.03*	*3,806.74*
Beyond ODA flows		12.79	29.33	26.87	20.14	20.94	63.77	193.23	238.78	201.07	108.13	323.31	133.10	1,371.47
Other Official flows	OECD DAC2b	0.01	8.73	1.41	6.00	4.14	17.99	164.90	162.70	134.99	69.19	146.36	64.03	780.45
Bilateral DAC OOFs (DAC2b)	OECD DAC2b	*0.01*	*0.50*	*0.17*	*0.00*	*0.14*	*6.94*	*30.51*	*24.63*	*30.81*	*17.04*	*30.58*	*18.72*	*160.05*
Multilateral OOFs (DAC2b)	OECD DAC2b		*8.23*	*1.24*	*6.00*	*4.00*	*11.05*	*134.39*	*138.07*	*104.18*	*52.15*	*115.78*	*45.31*	*620.40*
Bilateral non-DAC		9.07	9.00	5.58	0.38	0.77	33.83	8.80	49.28	53.41	5.42	157.25	31.44	364.25
Non-China ODA	AidData* & DAC2a	*0.25*	*0.28*	*0.46*	*0.38*	*0.59*	*3.89*	*2.03*	*0.83*	*13.79*	*3.63*	*2.36*	*3.41*	*31.90*
*China ODA***	MFPED & AidData	*8.82*	*8.72*	*5.12*	*0.00*	*0.18*	*29.94*	*6.77*	*48.45*	*39.62*	*1.79*	*154.89*	*28.03*	*332.34*
China OOFs	N/A													*0.00*
Multilateral climate funds	Climate Funds Update	3.71	2.77	2.67	3.45	3.37	3.48	1.88	2.68	1.75	16.88	3.00	3.75	49.39
Philanthropy	Foundation Center	0.00	8.83	17.21	10.31	12.66	8.47	17.65	24.12	10.91	16.64	16.71	33.87	177.39
Sovereign bond issuance	MFPED	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total external finance		706.66	988.30	1,251.29	1,248.91	5,167.03	1,680.75	1,815.36	1,975.25	1,917.90	1,698.17	2,002.38	1,936.02	22,388.01

**Commitments for four countries: Brazil, India, Saudi Arabia, South Africa; all other data are disbursements. **ODA/OOF not separated*

Data as of 16 December 2015.

Sources: Data on ODA from the OECD CRS for DAC donors and multilateral development institutions; beyond-ODA data are the sum of OOFs (OECD DAC2b); climate finance (OECD CRS (GEF); Climate Funds Update); loans and grants from China (MoFPED; AidData); loans and grants from non-DAC donors (DAC2a; AidData); and philanthropic flows (Foundation Center).

Annex 4: List of interviewees

Name	Organisation
Keith J. Muhakanizi	Ministry of Finance, Planning and Economic Development
Charles Byaruhanga	Ministry of Finance, Planning and Economic Development
Martin Nsubuga	Ministry of Finance, Planning and Economic Development
Maris Wanyera	Ministry of Finance, Planning and Economic Development
Albert Musisi	Ministry of Finance, Planning and Economic Development
Joyce Ruhweeza	Ministry of Finance, Planning and Economic Development
Annie Sturesson	Ministry of Finance, Planning and Economic Development
Fred Kabagambe Kaliisa	Ministry of Energy and Mineral Development
Emmanuel Ajutu	Ministry of Energy and Mineral Development
Mohamed Ssemambo	Ministry of Water and Environment
Engr. Dr John Mbadhwe	Ministry of Works
Moses Mulengani	Ministry of Works
Sion Haworth	Ministry of Works
Drake Bagyenda	Ministry of Works
Alex Onen	Ministry of Works
Mathias Ofumbi	Uganda National Roads Authority
Lawrence Parion	Uganda National Roads Authority
Patrick Muleme	Uganda National Roads Authority
Sarah Namuli	Ministry of Education, Science and Sports
Elizabeth Katema	Ministry of Education, Science and Sports
Gladys Kizito	Ministry of Education, Science and Sports
Nelson Wannambi	Ministry of Education, Science and Sports
Hon. Amos Lugoloobi MP	Parliament of Uganda
Vera Kintu Oling	African Development Bank
Alexis Rwabizambuga	African Development Bank
Yasumichi Araki	Japan International Cooperation Agency
Judith Zungu Mutabazi	Japan International Cooperation Agency
Jean-Pascal Nguessa Nganou	World Bank
Theo Hoorntje	Delegation of European Commission
Dr Stefan Lock	Delegation of European Commission
Samuel Kajoba	Royal Norwegian Embassy
Ouyang Daobing	Embassy of China
Jacqueline Wakhweya	USAID
Lawrence Lin	USAID
Chris Bold	DFID
Howard Standen	DFID
Virginie Leroy	Agence Française de Développement
Anja Nina Kramer	KfW
Ezra Munyambonera	Economic Policy Research Centre
Paul Lakuma Corti	Economic Policy Research Centre
Joseph Mawejje	Economic Policy Research Centre
Richard Ssewakiryanga	Uganda National NGO Forum
Julius Mukunda	Civil Society Budget Advocacy Group

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Cover photo: Reuters/James Akena, 2015. A woman working in a construction site moves building material in a section of a new hospital in Hoima town, Uganda, April 27, 2015.

Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ
Tel +44 (0)20 7922 0300
Fax +44 (0)20 7922 0399

odi.org