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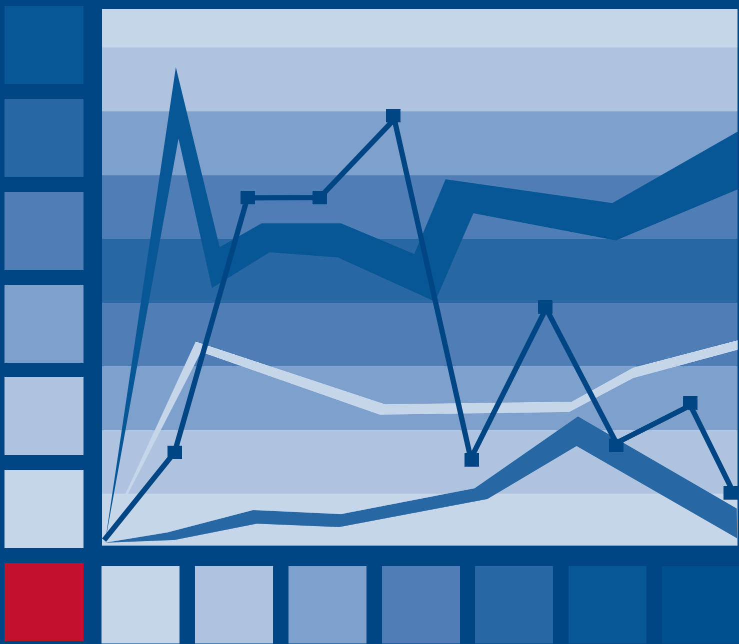

ECONOMIC POLICIES IN UGANDA

and the principles of social market economy

Evarist Twimukye

Konrad
Adenauer
Stiftung

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Konrad-Adenauer-Stiftung, Uganda Programme
51A, Prince Charles Drive, Kololo
P.O. Box 647, Kampala
Tel. +256 414 25 46 11
www.kas.de

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Author:
Dr. Evarist Twimukye

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Foreword

Freedom and responsibility – the realisation that those two principles go hand in hand is at the core of the concept of Social Market Economy. Since its initial political implementation in the early years of the Federal Republic of Germany, the Social Market Economy has turned out to be a meaningful and better alternative to the two extremes of centralist socialism and unbridled capitalism. The concept is not only the basis for the success story of the German economy. It also offers a useful approach for managing the global economy, particularly in light of the recent crisis, as well as ensuring meaningful social and economic policies in developing countries, including Uganda.

Social Market Economy offers an approach for an economic and social order that combines in an ideal way economic liberties, social responsibility and democratic rule of law. In this light, the promotion of democracy and rule of law and the promotion of meaningful social and economic policies are considered to be crucial and complementary elements in the work of the Konrad-Adenauer-Stiftung (KAS) worldwide.

The linkage of the principle of a free market with the principles of social balance and individual responsibility, based on the guiding concepts of subsidiarity and solidarity, offers important lessons for countries across the globe. As a German political foundation, the Konrad-Adenauer-Stiftung has a strong interest in sharing the positive experiences with the Social Market Economy in Germany. It is our conviction that its principles and features have a universal relevance and therefore deserve to be promoted through meaningful dialogue. Complying with the legacy of Konrad Adenauer, the foundation is convinced that social market economy is not only a suitable overall system of order for national development but also one of the most precious export articles of Germany.

Looking back at the success story of Social Market Economy over six decades, it is the aim of the Konrad-Adenauer-Stiftung to raise awareness on the concept and its principles and promote some major features included in this concept as best practices, which can be applied even in the context of African developing countries and can help improving social and economic policies in a country like Uganda.

From 2011, the traditional focus in the work of the Konrad-Adenauer-Stiftung in Uganda – the promotion of democracy, rule of law and the participation of civil society – is being rounded off by a new component which is the promotion of the principles of Social Market Economy. However, the approach is based on the idea of dialoguing and exchanging experiences and best practices. We do not understand Social Market Economy as a completely predefined economic model that can simply be exported to or copied in Uganda. Instead, the main features and principles can offer interesting lessons and guidelines for policymakers and other stakeholders in Uganda. The Konrad-Adenauer-Stiftung aims to raise the general awareness about the concept of Social Market Economy and facilitate an ongoing dialogue about the relevance of its core principles in the Ugandan context.

In a first step, KAS Uganda has contracted a Ugandan economic expert to develop this paper. The aim of this paper is to set a starting point for subsequent discussions about Social Market Economy in the Ugandan context by providing a comprehensive assessment of the economic status quo and the current economic policies in Uganda as compared to the principles of Social Market Economy. These principles are thereby not understood as fixed prescriptions but rather as guidelines that can inspire a meaningful regime of social and economic policies in the country. The paper takes a critical look at current economic policies in Uganda with a particular focus on whether – implicitly or explicitly – certain social market economy principles are already being followed or not. It also discusses the general relevance and applicability of the same principles in the current Ugandan context.

The author, Dr. Evarist Twimukye, is an outstanding Ugandan economist and well-qualified expert on the matter. Among other tasks he has been analysing the Ugandan economy for the African Development Bank, the UN and the OECD. Until recently he was a Senior Research Fellow and the Head of the Department of Macro-economics at the Economic Policy Research Centre (EPRC), before moving to Southern Sudan, where he is now working as Chief Technical Advisor for the United Nations Development Programme (UNDP). I am confident that his paper will enrich the academic discourse as well as political discussions and will continue to trigger an important dialogue about meaningful social and economic policies in Uganda. If taken seriously, the universal lessons and guidelines that the concept of Social Market Economy provides can decisively boost Uganda's preparedness for the economic and social challenges ahead.

Peter Girke
KAS Country Representative

Acronyms / Abbreviations

AIDS	Acquired Immune Deficiency Syndrome
BoU	Bank of Uganda
CGE	Computable General Equilibrium
CHOGM	Commonwealth Heads of Government Meeting
CTL	Commercial Transaction Levy
EAC	East African Community
EARC	East African Royal Commission
ERP	Economic Recovery Programme
GAVI	Global Alliance for Vaccines and Immunisation
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
HIV	Human Immunodeficiency Virus
IMF	International Monetary Fund
ITA	Income Tax Act
KAS	Konrad-Adenauer-Stiftung
MDG	Millennium Development Goal
MoFPED	Ministry of Finance Planning and Economic Development
MSC	Marginal Social Cost
NAADS	National Agricultural Advisory Services
NCE	Non-Coffee Exports
NDP	National Development Plan
NEMA	National Environment Management Authority
NPA	National Planning Authority
NRA	National Resistance Army
NRM	National Resistance Movement

NSSF	National Social Security Fund
OECD	Organisation for Economic Co-operation and Development
PAF	Poverty Action Fund
PAYE	Pay As You Earn
PEAP	Poverty Eradication Action Plan
PMA	Plan for Modernisation of Agriculture
PPP	Purchasing Power Parity
RDC	Resident District Commissioner
REPO	Repurchase Agreement
SAP	Structural Adjustment Programme
UBOS	Uganda Bureau of Statistics
UGX	Uganda Shilling
UIA	Uganda Investment Authority
UNHS	Uganda National Household Surveys
UPE	Universal Primary Education
URA	Uganda Revenue Authority
USD	United States Dollar
USE	Uganda Securities Exchange
USE	Universal Secondary Education
VAT	Value Added Tax

1. Background

Since independence, African countries, including Uganda, have been grappling with how to transform their economies and improve the welfare of their societies. But the record of their success has been mixed. Whereas some have presided over unprecedented periods of growth, poverty and inequality still pervade most of these countries. Consequently there have been calls for the reassessment of the economic policies these countries have adopted. At this time of its development Uganda is, for example, at a crossroads. The country made a remarkable turnaround in economic performance over the last two decades, with impressive growth rates (7 percent on average) and a sharp decline in poverty rates. But a worsening distribution of income, limited socioeconomic transformation and growing unemployment, especially among the youth, have raised a lot of concern. Sections of the population, especially the rural population who depend on agriculture for their livelihood, have been left out as the sector's productivity plummets. Growth has recently come from the services sector, which largely employs the highly skilled and few from the agricultural sector, which still employs 70 percent of the population.

There is now fear that this state of affairs may lead to social tensions and this has led some to suggest that perhaps the policies that have brought the country this far may need some revision. Alternative policy options are hard to come by as the collapse of communism in the late 1980s and recently the strains in the capitalist economies make the world nervous about either system. Against that background, the social market economy, Germany's distinguished 'Third Way' of regulatory policy between centralist socialism and unbridled capitalism, can be seen as a better possible alternative for countries like Uganda. Its success in Germany, particularly during the recent worldwide economic crisis, has distinguished it as a model for economic and social stability and peace, rooted in its focus on the human being.

Therefore, this study provides a comprehensive review of the basic features, successes and challenges of the economic policies and economic regulation in Uganda and compares these to the normative principles of and societal and economic preconditions for the social market economy. The study aims to assess whether those principles are applicable and relevant to the Ugandan context and to what extent the required preconditions are present in Uganda or are being promoted through government policies.

The study assesses whether Uganda's economic status, regulation and policies conform to the elements of a social market economy, namely competitive order; a market system and free access to the market; private property; freedom of contract; rule of law; regular and steady economic policy; monetary stability; state intervention in case of market failure; social balance and social security; and provision of public goods by the state.

It then considers whether the following principles of a social market economy are reflected in Ugandan society and the Ugandan economy: freedom and individualism (individual liberties/individual freedom); order (provision of a structured economic order by the state); justice (a just and fair society, equal opportunities); responsibility (individual autonomy and social responsibility); performance orientation; competition on the merits; solidarity; subsidiarity; and common welfare. The study then assesses which principles may be relevant to Uganda and which may not and outlines how customisation of such principles to the Ugandan situation may help the country's economy and society to transform in a more balanced, inclusive and sustainable manner.

2. The Features, Principles and Benefits of a Social Market Economy

The social market economy as a system has stood the test of time because of its unique attributes that make it a balanced and stable framework for organising an economy. Not only does it focus on the individual, but it also creates mechanisms for self-correction, ensuring that when there is market failure, the government is prepared to intervene on behalf of those who are hurt by that failure. The one way, therefore, to make it possible for the system to be applicable in other situations and countries, is to understand those features that make it such an attractive system and to assess the possibility of replicating such a system.

2.1 Background and Features of the Social Market Economy Concept

The social market economy was conceived in Germany before and after World War l on what was then called ordoliberal reasoning as a potential post-war economic order (Ahrens, 2008). The system was mainly championed by Ludwig Erhard, a former Federal Germany Economics Minister and later Federal Chancellor who is credited with the economic and currency reform of 1948 which initiated the implementation of a realistic concept of a market economy based on social issues. The term 'social market economy' itself was, however, coined by Müller-Armack, one of the members of an intellectual group of post-World War l thinkers and representatives of the so-called 'economic and social humanism'. But the social market economy system found its way into the mainstream German economic policy, after a contemporary of Ludwig Erhard and a notable ideologue of the system, Konrad Adenauer, was elected the first Federal German Chancellor in 1949. In a way, by electing Konrad Adenauer, the German people had voted for the social market economy, and since then the system has become the country's main political-economic model.

The system was mainly conceived as an answer to the interventionist economic policy after World War l and the war economy of the Nazi regime which was marked by a comprehensive system of state-imposed price control and management regulation. It also has its roots in Christian ethics and a Christian concept of man as modern Catholic social studies developed and the Church started addressing the conditions of the working classes and debating the solutions that had been offered by competing liberalist and socialist theories on economic order.

However, the first real application of the system has its historical roots in the tragedy that Germany suffered in the World War ll. Marktanner (2008) outlines three factors that may have galvanised the originators of the system into action. These were the necessity to overcome the hardship that Germans experienced on the ground, the need to spread confidence in the new political-economic system, and a reflection of the paradigm shift in economics that set in with the Great Depression as economists began to advocate stronger states and to question the universal blessings of markets.

The concept was not modelled on the socialist ideology, yet it was different from the capitalist system. Indeed, it did not aim at doing away with the market through a command economy but looked at the role of the state as meant to create a market order in which individuals are responsible for the market outcomes, with government intervening only in a limited manner, mainly when the market fails. Thus, the original social market economy does not develop its social characteristics through artificially imposing apparently social elements (favouring particular groups in society) onto an otherwise free market system. Rather, the attribute *social* is to be justified through the functions of economic competition and technological progress leading to economic growth processes, which allow a socially just distribution of income increases (Ahrens, 2008).

The idea is that a competitive market economy through private initiative should be linked with social progress. The society is only as developed as its people and an economic system that does not put people at the heart of development is bound to have problems. The issue is that the market is inherently imperfect and government can work to mitigate the impact on the population of the market shortcomings. Therefore, in its heart is the harmonisation of economic freedoms with social justice (Marktanner, 2008).

2.2 Principles of a Social Market Economy

A social market economy has principles that have made it an attractive system for not only Germany, where it started, but now to the greater European Union and beyond. These principles are the cornerstone for a well balanced system that ensures that even as individuals are given the opportunity to work to their fullest potential, the common good and social cohesion are maintained. The idea is that these principles cater for all the needs, both private and social. These principles create a favourable environment for individual ingenuity, but backed by a strong public and social anchor so that in situations where the individual attributes fail to deliver for an individual, there are still the family, the community, and government as support. The following section outlines these principles, highlighting what makes them an anchor to a stable and coherent system that has stood the test of time.

2.2.1 Freedom and individualism

The principles of freedom and individualism refer to the upholding of individual liberties and freedoms. The originators of the social market economy concept averred that human beings and their right to a dignified existence should be at the core of socioeconomic development. The idea is that each individual should have the right to get a chance of developing his/her potential, as well as the obligation to make good use of it (KAS, 2008.) This in a way puts the individual's responsibilities and welfare at the centre, and this distinguishes it from the socialist system which emphasises mainly collectivistic approaches.

This also means that the individual is free to make choices without undue interference. This implies in economic terms that an individual has freedom over purchase, contract, of action, and the freedom to choose employment and to pursue their own goals in order to develop their own personality by using all their faculties of creative competitiveness. This is a positive attribute in as far as it brings out the best in people. It makes individuals work to the best of their ability within the limits set by the social system. But the principle has in some cases been abused, with individuals acting in ways that may be inconsistent with societal norms and customs. Consequently, you end up with chaos. This, therefore, calls for ways to regulate the behavior of individuals so that they conform to what the society consider normal.

2.2.2 Order

This means that the state should provide a structured economic order or set the rules upon which the society operates and that individuals are given the freedom to do what they want but within those universally acceptable rules. The economy has to be governed by public and civil laws, for example tax laws, social law, contract law and labour law. This type of regulation guards against the anarchy and injustice that may ensue if individual and societal actions were to be left unregulated. In setting the rules, however, the state guards against the temptation to interfere with the market's self-adjustment in what would then amount to interventionism. This principle has been important for many countries that have implemented a social market economy, setting dimensions within which society is organised, and putting predictability in how society behaves. But these principles may be subject to abuse when those in power seek to justify repression with the need for maintaining order in society. This has often led to the violation of peoples' rights. This requires, therefore, that this principle is implemented with safeguards.

2.2.3 Justice

Justice as a principle within the concept of the social market economy refers to the creation of a fair society where all individuals have equal opportunities. This ensures that there is justice, equality and fairness in all aspects of the society. There are a number of areas in which justice may be applicable, including just payment for performance, just satisfaction of human needs, equal opportunities, just allocation of goods and services, fair exchange of goods and services, fairness on the market, equal participation in the rights and duties of public welfare, inter-generational justice, and commutative justice (Hass *etal.*, 2008). But justice is sometimes very difficult to achieve because of the conflicting needs to ensure justice without negating the importance of individual effort and performance. For example, payment for labour may depend on the quality of labour, which may appear to favour the more skilled and may seem to be unjust to the less skilled. Yet commensurate pay is the cornerstone of a social market economy. What this means, therefore, is that justice in a social market economy seeks to reward performance while at the same time minimising the differences in society and creating a harmonious society.

2.2.4 Responsibility

The principle of responsibility implies that individuals can act autonomously but their actions should be linked to societal needs and all should have responsibility to the society in which they live. This will ensure that there is solidarity in both good times and bad times and that the disadvantaged in society, such as children, the sick and the old, are cared for. Part of this may require that the traditional support system, such as the family, is strengthened to take care of the disadvantaged in society. In a social market economy, emphasis is also placed on environmental and natural resource protection to ensure inter-generational sustainability. A responsible individual and society also promote peace and sustainable development both in their own country and abroad. This principle is important in creating a compassionate society, short of which you will create a faceless society that would have large sections of the population left out. But the principle may be abused by making people shirk responsibility for their wellbeing, as they wait for others to take responsibility for them. This has led to high dependency rates in some countries. This often burdens a few individuals and may be a disincentive to undertaking productive work.

2.2.5 Performance orientation

As noted above, in a social market economy, individuals have the freedom to work as hard as they can and their performance is the basis for reward and success in the market. This is the whole basis for the concept of just pay and this must be followed to allow incentivised work or else there would be shirking, low productivity, or even emigration as individuals look for where they can get fair pay for their work.

In the case of the disadvantaged, there are always the values of solidarity and subsidiarity to help those who are not able to attain a sufficient income through no fault of their own. Such personal limitations may emanate from illness, disability or any other reason that may exclude them from the labour market and lower their chances of earning a living. These should, however, be exceptions – the norm should be that performance is the basis for reward. The importance of this principle is the fact that it acts as an incentive that makes individuals and society focused on performance. It ensures that as long as you work hard, you get rewarded for it. But this in its pure form can be inhuman when abilities are the yardstick for reward, considering that some individuals in the society may fail to perform for reasons beyond their control. This may require that government makes interventions to support those individuals who cannot forge ahead without a helping hand.

2.2.6 Competition on the merits

The OECD defines 'competition on the merits' as a situation where a dominant enterprise can lawfully engage in conduct that falls within the area circumscribed by that phrase, even if the consequence of that conduct is that rivals are forced to exit the market or their entry or expansion is discouraged (OECD, 2006). While it is widely agreed that the purpose of competition policy is to protect competition, not competitors, there is less agreement on how to go about doing that. There are means with which regulators have always tried to measure whether competition is on the merits or not. Three tests are usually employed, including the no-economic-sense test, equally efficient firm test, and consumer welfare balancing tests. The no-economic-sense test states that conduct should not be condemned unless it would make no economic sense but for a tendency to eliminate or lessen competition. The equally efficient firm test (which is sometimes called the 'as efficient competitor' test) states that conduct should be unlawful if it would be likely to exclude a rival that is at least as efficient as the dominant firm is. Consumer welfare balancing tests determine whether conduct should be unlawful by requiring decision-makers to weigh the positive and negative effects that the conduct has on consumer welfare.

2.2.7 Solidarity

Solidarity means that even when individual performance and reward are cherished in a society, feeling for others may be needed to ensure a harmonious and cohesive society. Care for the needs, interests and challenges of others is an ethical issue and it ensures that there is solidarity to deliver common wellbeing. There are also incentives for individuals to be part of that solidarity given the fleeting nature of wellbeing, in the sense that everybody contributes all they can with the hope that when they are in need society will cater for them. This principle is important because a society which helps those in need is likely to develop sustainably. However, this may be abused when solidarity replaces individuals' responsibility to themselves. This may create a group of people who may begin to think that others' solidarity is a right they are entitled to. This may negate the essence of individual performance and self-sustenance.

2.2.8 Subsidiarity

Subsidiarity refers to the responsibility that human beings have for themselves, ensuring that no one should look to others for help but rather to themselves. This extends from individual to family to community, who are thought to offer better help to their own instead of looking outside. In that sense the principle ensures that there is no social body performing functions that the individual or a subordinate social body can perform effectively from their own responsibility and resources (Hass *et al*., 2008). This principle is important because individuals and a society that ensure that their sustenance is their own responsibility is likely to develop their welfare sustainably. Looking to others for even the smallest of one's needs negates the essence of work. This principle has helped countries like Germany to live within their means and this is a more sustainable way to cause development. The principle, however, should not be used to deny help to others when such help would have alleviated their vulnerability. There should always be room for helping out those who cannot help themselves.

2.2.9 Common welfare

The principle of common welfare derives from the solidarity principle where members need to help each other. This leads to common welfare that can also be ensured by the public system in the sense that whereas all people should take part in creating wealth, they should also take part in sharing that societal wealth. This means that the right of an individual to societal wealth may also depend on the duty that they have to create that wealth. The state then comes in to tax and impose levies on individual wealth to provide public goods that will benefit the society as a whole. But for the state to manage these institutions they have to be independent and efficient and laws have to be followed to the letter. Short of that, the taxes that are levied on the more fortunate members of the society may, for example, not be used for the common good but instead to create a more exclusive group of the privileged.

2.3 The Benefits of the Social Market Economy

The benefits of the social market economy derive from its principles. It can be argued that this system has served the Germans well since it was first implemented in 1949. The system combines in a meaningful manner the elements of a capitalist state and a socialist state, making it a free but compassionate system. Whereas it allows individuals personal liberties and gives them the tools to be as innovative as possible, it also ensures that responsibility to others and to the nation is not lost in the greed for success.

The social market economy ensures that the state is well tuned to the needs of its citizens and works for their welfare, a situation that creates harmony in the society and gives power to the people. This is important because leaders become accountable to the people and failure to deliver leads to censure or even being voted out of power. This leads to efficiency and a people-centred development path.

Because the social market economy is centred on the individual, everybody has a right to share in the welfare or success of the nation and no group of people succeeds in capturing the state and the economy. Individuals take responsibility for whatever they do, aware that any benefits from their sweat will not be appropriated by others. This creates incentivised work that leads to increased productivity and national development.

Moreover, the solidarity and common welfare principles ensure that the system caters for those in the society that might be less fortunate, making the nation a more compassionate one and one likely to be appreciated and supported by the population. This encourages everybody to work hard in the sure knowledge that in old age or in case of any disability, the fruits of that work will be a source of livelihood. But the most important benefit of the system is the stability it creates as a system of socioeconomic development. All the principles add up to create a system that brings out the best in people and that is also stable owing to the social support system. On the economic front, the system is business-friendly, creating an environment in which enterprise can flourish. The freedom to engage in business and pursue profit is the basis for incentivised performance and economic transformation. The order created by the system makes it easy to make strategic business decisions, which is the backbone of private enterprise.

Moreover, the support these governments extend to the market helps enterprises withstand shocks that are bound to occur in a market. This has, for example, come in handy when there has been an economic slowdown where government intervention has been the only way to prevent total collapse. It can, therefore, be safely said that, left alone, markets would collapse to the detriment of the society. Apart from situations where governments have intervened in the economy times of crisis, this is often part of economic policy which creates a very strong institutional and infrastructural environment that helps business to succeed.

On the social front, the principles that deal with caring for the weak and vulnerable create a stable society, as opposed to a faceless society that pure capitalist systems create. The result is that individuals feel they are part of the society and work hard to make the country succeed. The social fabric is strong, which forms a base for a strong state. And as individuals feel secure in their community, they work hard to make sure everybody succeeds. At family and community levels, the care that individuals and society give to each other creates a society that feels secure and looks out for inter-generational needs. Even politically, this inclusivity creates stability as individuals feel they have a say in the affairs of their country and that government works for their welfare. This reduces social tensions and is a basis for stability.

3. State of Uganda's Economy and Economic Policies with Regard to Social Market Economy Principles

For more than two decades, the Ugandan government has been trying to transform the economy and embark on a sustainable development path. However, there has not been a coherent economic structure, with the policies oscillating between attempts at socialism (in the 1980s) through a mixed economy (in the1990s) to almost a pure capitalist state (in the early 2000s) before the recent introduction of strategic interventions in the economy. These various economic experiments create a problem for analysts who would want to understand the country's economic system. But a critical look at the economy and economic policies, especially in the last two decades, shows that the seemingly chaotic system actually had important features that can be assessed and compared to other economic systems.

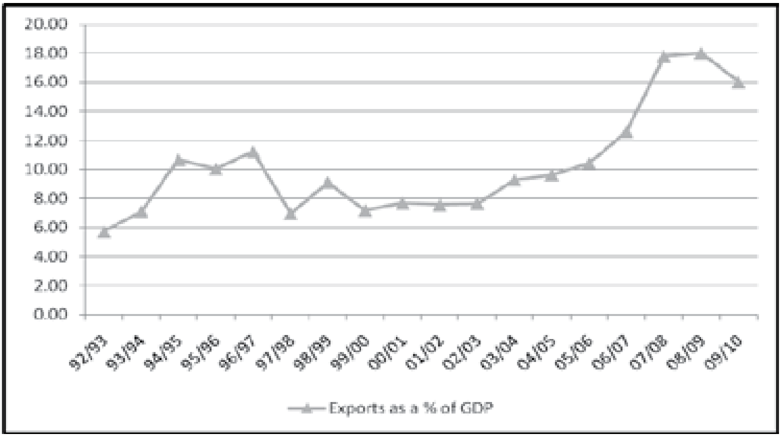
It is against this background that this study sets about assessing Uganda's economy and economic policies to see if the elements of the social market economy are reflected therein. The major elements that the social market economy are reflected therein. The major elements that the social market economies conform to are looked at one by one and assessed against the Ugandan economy and policies. For any economic system to work there are certain economic and institutional preconditions that have to be implemented. This study assesses whether these preconditions for a social market economy are reflected in the policies that Uganda has implemented so far.

3.1 Competitive Order

Competition is a major element of a modern economy and the stronger the presence of competitive players in the economy, the more likely the economy is to mature into a modern one. This is because competition leads to efficiency and is consistent with enhancing fairness in the creation and sharing of wealth. How competitive an economy is may depend on a number of attributes, including economic openness. One important element of a competitive economy that conforms to the social market economy is that it should be open to trade within its borders and with the rest of the world.

For Uganda's economy, therefore, to qualify as a social market economy, it should be an open economy. For the last two decades or so Uganda has been opening up its economy to international trade. Consequently, exports as a share of gross domestic product (GDP) have been increasing over time (Figure 1).

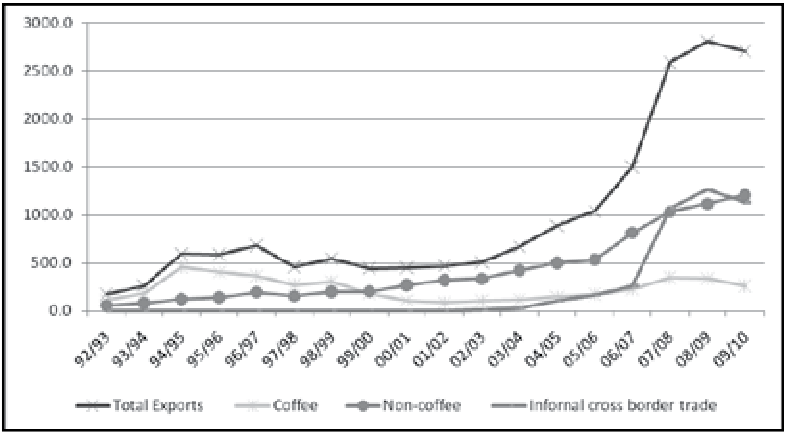
Figure 1: Exports as percentage of GDP



Source: Bank of Uganda, 2009

Prior to the liberalisation of the economy and the emphasis on import substitution and export diversification in the 1990s, Uganda depended mainly on coffee as the main export. This was a major constraint on the country's terms of trade, especially when the world coffee prices dropped as was the case in the mid-1990s. But to insulate the economy from the adverse terms of trade and instability in export earnings associated with commodity concentration, there was a policy shift in 1987 to diversify the country's exports base to include non-traditional (mainly agricultural) exports, as will be discussed later. Since then, the country has diversified its exports base and there is now an increasing role played by non-traditional exports such as flowers, fish and other agricultural exports, the so-called Non-Coffee Exports (NCE) (Figure 2).

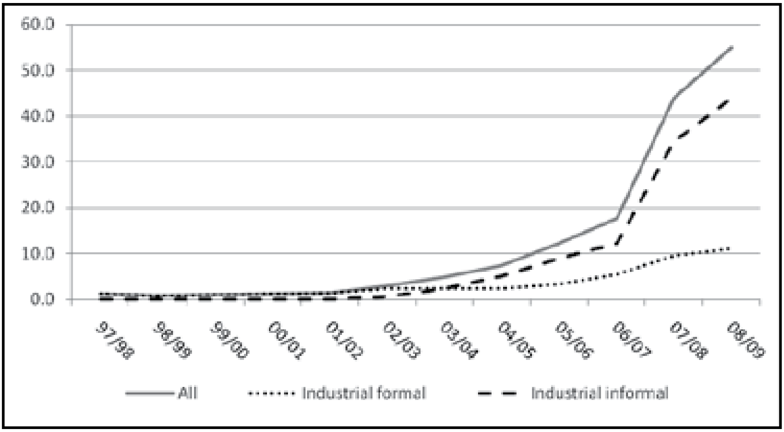
Figure 2: Uganda's exports (million USD), 1997-2008



Source: Bank of Uganda, Annual Report 2008/09

This level of trade liberalisation has managed to reverse Uganda's trade deficit through export-oriented trade and market-determined exchange rate policies. In spite of this increased diversification of the export base, however, Uganda still relies mainly on primary commodity exports, with the percentage of industrial products among the exports only standing at 11.0 percent in 2008/09. However, when informal cross-border trade is taken into account, the overall share of industrial products in the total exports was 54.9 percent in 2008/09 (Figure 3). It should be pointed out that, as new emerging export markets within the region stabilise, it would be difficult for Uganda to sustain the industrial product export growth.

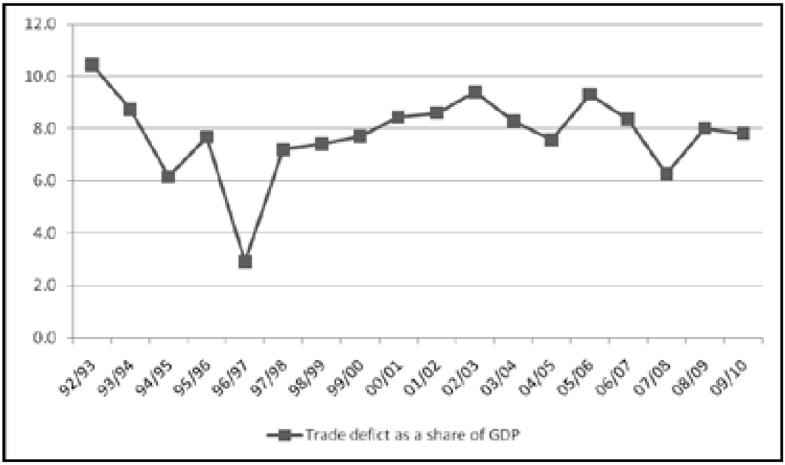
Figure 3: Share of industrial products in total exports, 1997/98-2008/09



Source: Bank of Uganda, Annual Report 2008/09

This has implications for the competitiveness of the economy, as many primary commodities earn only a fraction of what they would earn if they had been processed. Consequently, although the Uganda shilling (UGX) depreciated against the US dollar (USD) in real terms from UGX 558 to UGX 2000 per USD between 1987 and 2008, implying higher domestic producer prices in Uganda shillings, the trade balance did not improve that much. In absolute terms, the negative trade balance deteriorated from USD 446.73 million in 1997/98 to USD 936.31 million in 2008/09. However, since 2005/06, the trade deficit as a share of GDP has declined (Figure 4).

Figure 4: Trade deficit as a share of GDP



Source: Bank of Uganda, 2009

Therefore, whereas the Uganda has opened up its market, creating enormous potential for exports and foreign capital, the high negative trade balance does not augur well for the future. This has sometimes caused disturbances in the country due to an increase in the prices of goods, many of which are imported. Thus, it is not easy to see how the principles of a social market economy, such as subsidiarity, would be achieved when the country continues to rely heavily on imports. Efforts to diversify the economy in order to enhance exports could be a good starting point for meeting the tenets of a social market economy.

3.2 Market System and Free Access to the Market

One of the major features of a social market economy is that it should be a free market in which the freedom to transact is guaranteed. As noted before, however, this freedom is not sacrosanct since it takes place within limits dictated by the norms of the society. Nevertheless, the importance of this freedom cannot be overemphasised and this indeed should not be taken away on the pretext of interventionism. The ability to reach the market, therefore, guarantees that the barriers to entry are kept at a minimum and are only imposed for the benefit of society. These barriers, however, should never be imposed to favour one party or another unless this is absolutely necessary. This means, therefore, that there should not be collusion by any powers to exclude some from the market and government should never act as a guarantor of any unfair advantage.

Superficially, one might say there is market access in Uganda because the government does not intentionally bar people from accessing the market. Businesses open every day and buyers can buy most of what they want from the market. But this seemingly free market access is not always assured. In most cases, barriers to entry crop up that are not necessarily intended. Take, for example, unfair taxation that sometimes favours sections of the population against others. The result is the exclusion of some businesses or individuals from the market through predatory pricing. Consequently, those favoured by the taxes reap abnormal profits whereas others are pushed out of the market owing to unsustainable profit margins.

There are many other barriers to entry that keep people from accessing the market not only as sellers but also as buyers. And government usually does not come in to help people to access the market. Take another example: lack of credit that is a serious problem to many businesses in Uganda. Even when a business would have succeeded in the market, lack of credit may cripple it, thereby preventing it from accessing or remaining in business. The whole essence of government intervention in the social market economy is to help lower those barriers that businesses face as they try to access the market or helping those who are already in business not to exit. This help also extends to buyers as governments sometimes need to help those vulnerable and disadvantaged individuals who cannot afford the goods and services offered in the market. In Uganda, this help is not usually offered, resulting in sections of the population being left out of the market.

3.3 Private Property

The proper functioning of the economy requires that there is free access to the market and the right to ownership of private property is fully respected. Access to the factors of production (land, capital and labour) and the freedom to exchange these factors is a prerequisite for a properly functioning economy.

3.3.1 Uganda's land laws

The rights to land are still one of the most contentious issues in the country. However, this is not a recent phenomenon because historically land rights have always been at the heart of Uganda's political and social discourse. When Uganda was colonised, the British protectorate administration declared most land in the territory Crown land. Customary land tenure was recognised but within limits. Under the *Crown Lands Ordinance 1903*, indigenous Ugandans had the right to occupy any land (outside the Buganda kingdom and urban areas) not granted in freehold or leasehold without prior licence or consent in accordance with their customary law.

But as if to take away those rights, the Governor had the power to sell or lease such land to any other person without reference to the customary occupants of the land. Moreover, compensation was payable to the displaced occupants at the discretion of the Governor. The only right the customary occupants had was to remain in occupation of the land until arrangements, approved in writing by the Governor, were made to relocate them to other land.

It is safe, therefore, to say that Ugandans' rights to land in the colonial times were very constrained. Subsequently, however, there were moves to increase the rights of individuals to land by reforming the customary land system. The argument was that the communal nature of land does not conform to the tenets of a modern economy because individuals have no incentives to invest in the land to increase its productivity or make long-term improvement to it. Another disadvantage was that land occupants could not get sufficient assurance that their long-term land rights were secure.

There was also the issue of the inability to use their land rights as collateral for business/agricultural loans because financial institutions did not recognise customary titles. Other limitations were the fact that under customary land tenure, land was of no commercial value, and could not be treated as a commodity that could be sold, leased, mortgaged or otherwise dealt with commercially.

It is in this light that the colonial administration in 1955 commissioned what they called the East African Royal Commission (EARC) to study the possibility of reforming land tenure to make it more responsive to the needs of the population. The commission came up with a report that recommended to the administration the adoption of policies that would individualise land ownership and the mobility of land transfer. Though resisted by some quarters, the report was eventually adopted by some of the more heavily populated areas of the country, notably Kigezi, Ankole and Bugisu, which were convinced that the demarcation and registration of individual titles would give customary landowners secure titles and would eliminate disputes over ownership and land boundaries. Land owners in those three districts were then given land rights under the *Registration of Titles Act* and that marked the first attempt at ensuring that Ugandans have rights to their land.

However, at independence in 1962 the policy was again to be resisted and whereas its implementation was completed in the three districts, it was not extended to other districts. That was partly due to the intensification of the original opposition and the increased agitation of the time, some of it peppered with socialist and nationalistic sentiments. Some Ugandans contended at the time that the arguments that customary land titles did not recognise land rights were misguided and that, in reality, in most customary land tenure systems individuals' rights over a specific piece of land and improvements were secure and virtually permanent and that the rights were inheritable and, in some cases, alienable to other group members. Other problems in the three project districts and lack of any meaningful evidence that those who had acquired land titles had increased the productivity of the land and that they had followed due process in sub-dividing the land made the process of title registration very difficult in the rest of the country.

After independence, and in the absence of any alternative policy to the EARC report to promote customary land tenure, what was formally Crown land after independence was merely renamed public land. However, from a legal point of view, the status of customary land tenure remained the same. Subsequent legislations, such as the *Public Land Act 1962* and *the Public Land Act* [Cap 21], gave indigenous Ugandans the right to occupy any unalienated public land without prior consent and prohibited the government from granting freehold (private and unrestrained ownership) or leasehold (time bound ownership) any public land that was lawfully occupied under customary tenure without the consent of the customary occupants. But applicants for land occupied by customary tenants had to furnish the government with evidence that the occupants consented to the application and the compensation payable to them. Failure to provide such evidence, or to pay the customary occupants compensation approved by the Minister, was grounds for revocation of the grants. But since the government of the day was aware that customary land tenure cannot be a good engine of economic development, they encouraged individuals to turn their land rights into either leasehold or freehold at their discretion.

This was the state of the land tenure system by early 1970 when Dictator Idi Amin overthrew the elected government and out of the blue enacted the *Land Reform Decree 1975*, which essentially sought to overhaul the country's land tenure system. Under the decree all land in Uganda was declared public land and land owned in freehold was converted to leases held from the government subject to development conditions. For customary land tenure, the decree removed the protection customary landowners had previously enjoyed under the *Public Lands Act 1969* and empowered the government to lease any land occupied by customary tenants to any person (including the occupants) without the consent of the occupants. The government's only legal obligation was to pay compensation for the improvements. The decree also abolished the right hitherto enjoyed by indigenous Ugandans to occupy in accordance with their customary law any unalienated public land (outside urban areas) without prior permission and made occupation of any public land without consent a criminal offence.

However, in effect this decree was largely not implemented and by the time of Amin's overthrow, customary land tenure had been left to develop on its own. But due partly due to most of the many concerns with ownership, the new Ugandan *Constitution* of 1995 vested land in Uganda in the citizens of Uganda owned under freehold, *mailo* (quasi-freehold), leasehold and customary tenure.

Article 237(4) of the Ugandan constitution empowers all Ugandan citizens owning land under customary tenure to acquire certificates of customary ownership in respect of their land in a manner prescribed by legislation. The *Land Act 1998* reiterates the constitutional right of individuals, families or communities owning land under customary tenure to apply for a certificate of customary ownership in respect of their land. The certificate of customary ownership is deemed by the act to be conclusive evidence of the customary rights and interests endorsed thereon. Subject to any restrictions endorsed on the certificate, generally, a certificate-holder – individual or group – has the right to deal with the land just like any other landowner. Thus, he or she may mortgage, lease or sell the land, except where such right is precluded or restricted by the certificate.

The constitution gives customary landowners the right to convert their title to freehold in accordance with any law enacted by Parliament and in the *Land Act 1998*. Section 10(1) of the act provides that any person, family, community, or communal land association, holding land under customary land tenure may convert their tenure to freehold by following the prescribed procedure. The normal practice is for customary owners to apply for a certificate of customary ownership and later, if they wish, apply to the relevant authority to convert their customary title to freehold. However, it would seem from the act that possession of a customary certificate of ownership is not a prerequisite for conversion to freehold; applicants may fast-track the process by directly applying to the authority to convert their customary tenure to freehold. Although the provision for conversion is mainly aimed at individuals, landowning groups or communities could also apply to convert their customary title to freehold. The *Land Act 1998* does not give the relevant authority discretion to decide whether or not to allow an applicant to convert their title to freehold. It seems that permission to change should be granted as long as the customary law of the community concerned recognises or provides for individual ownership. Upon conversion to freehold, the land is registered under the Torrens system legislation and it ceases to be subject to customary land law.

This state of land tenure, however, came to be severely tested in the last decade as absentee landlords with large chunks of land, especially in Buganda, began to sell to the very rich who started to evict tenants on land, depriving them of livelihood. Faced with incessant complaints by the tenants, in 2007 the government introduced in Parliament the Land

(Amendment) Bill 2007 aimed at the land evictions. But some critics viewed it as a government scheme to steal people's land, especially in Buganda where the kingdom and other absentee landlords have big chunks of land. The government, however, maintained that the intention of the bill was to protect helpless lawful, bona fide and customary occupants of land who face evictions. As of now, the land ownership problem has created problems for landlords who would like to develop or sell their land in cases where the land in question is occupied by squatters. This has acted as a disincentive to investment in land and has rendered big chunks of land unusable.

The conflicts between landlords and tenants, on one hand, and between landlords and government, on the other, have created some concern that they might in future be a basis of conflict. For land to be a factor of production with the possibility of transforming the Ugandan economy, these contradictions need to be sorted out so that investments in land are secure and profitable.

3.3.2 Uganda's labour laws

Uganda has an employment law that outlaws any discrimination in employment. The *Employment Act 2006* states that no one should be denied work on any basis. However, in practice, Uganda has one of the worst labour right regimes in the world. Whereas in principle labour unions are allowed, they are often ineffective and workers' rights are often abused with impunity. Similarly, whereas the labour laws outlaw any form of forced labour, in practice Ugandans are abused every day, working long hours, some with no or very little pay. This is compounded by the fact that the country has not adjusted the minimum wage for a long time now.

There is also the issue of unemployment, which has become one of the biggest problems for mainly the youth. Arguing that it has created an enabling environment in which anybody can work and earn a living, the government has not been doing enough, if anything at all, to help its citizens to access employment. This has created an army of mainly young men and women who leave higher institutions of learning with no hope of ever getting employed. There is often a lot of despondency mainly among the youth which some fear might lead to social upheaval. This runs counter to the principles of a social market economy. The whole essence of a social market economy is for the state to intervene and help out those sections of the population (in this case unemployed youth) that have been left out of the market. The Ugandan state has failed to do that, and if this state of affairs continues, it will derail all the recent gains in economic and social development.

3.3.3 Capital ownership and privatisation

The capital market in Uganda is still very limited with the Uganda Securities Exchange (UCE) having been opened just in 1998 and still very small. Nevertheless the government has since the 1990s progressively divested itself of most of the roughly 107 public enterprises that were in existence then. The process made sense at the time because the enterprises were inefficient and unable to generate enough resources to finance their operations and save for re-investment, in addition to increasing the public debt through indirect and direct subsidies.

Some of the benefits of the process were an increase in tax revenues from divested enterprises, improved productivity and competitiveness, and job creation. The privatisation process has resulted in increased government revenue generation. However, the major concern in the divestiture process was corruption, for example during the sale of the former Uganda Commercial Bank, Nile Bank and Apollo Hotel. Secondly, the public as major stakeholders have often complained that they never got to know how the divesture proceeds were utilised. There was also little or no pre-post layoff support including counselling, retraining and redeployment programmes that would have helped laid off workers reintegrate into the labour market. The treatment of employment liabilities has been on an ad hoc basis and lacked a clear retrenchment benefits policy.

3.4 Freedom of Contract

Contracts are rules that govern transactions and their sanctity is very important for a properly functioning economy. A nation that does not respect contracts cannot hope to be taken seriously in dealings with other players. Not only should contracts be respected but freedom to enter into any contractual arrangement should also be guaranteed. Freedom of contract is, therefore, one of the prerequisites for a social market economy. It ensures that economic, financial or any other transactions that individuals or entities enter into are respected and binding and cannot be revoked at the whim of anybody, not even the government. This not only creates order in the system but it also assures players in the economy of their interests and encourages investment.

In Uganda, contracts are often not respected, and whereas breach of contract can be a reason for legal action, the corruption and the inefficiency in the judicial system ensure that some people get away with reneging on contractual obligations. Moreover, the percentages of contractual arrangements that are made legally are minimal. The majority of transactions are made informally, where the parties rely only on trust, sometimes leading to conflicts as one party fails to adhere to the terms of the contract. This has often acted as a disincentive to business and has affected mainly the financial system, where there are very few guarantees for extending credit to businesses. The result has been a business sector starved of capital. This lack of trust in the sanctity of transactions has adversely affected private enterprise and is bad for economic growth.

3.5 Rule of Law

The rule of law is one of the most important prerequisites for a properly functioning society - socially, politically, culturally, economically or otherwise. This is because a country with no rule of law cannot give its citizens their rights and is also not likely to conform to the principles of a social market economy. The rule of law, therefore, is a prerequisite for a social market economy. Conforming to the tenets of rule of law ensures that individuals are free to do what they want within the limitations of the law of the land and that there is equal opportunity for everybody. Below we look at Uganda's experience with governance as it impacts the rule of law in the country.

One of the indicators of how the country is fairing with the rule of law is the status of governance in the country. In this area, Uganda has had a checkered history since independence as its politics has gone through different types of government, including military government, parliamentary government and now a presidential system. The country descended into civil war in the 1980s, a culmination of two decades of political instability following independence in 1962. The main cause of the political instability was rivalry for political power among different ethnic and religious groups, principally between the traditional Bantu landowning elites in the south and west of the country and various Nilotic peoples in the north and east. Though seemingly a democracy, the government of the day, led by Milton Obote, became increasingly dictatorial, and was eventually overthrown by a military coup led by Idi Amin in 1971.

There was more turbulence all through Amin's regime as well as the second Obote rule and one by General Tito Okello who overthrew him. This state of affairs continued until the National Resistance Movement (NRM), using its armed wing the National Resistance Army (NRA), came to power in 1986 in an armed rebellion that it had waged against the government since 1981. During the entire period from independence up to 1986, governance had been problematic, partly because of the level of political instability but also because of the lack of respect for human rights by the governments that were in charge.

But with the accession to power of President Yoweri Museveni at the head of the NRM government, there were initial efforts to improve governance. The government has moved to promote good governance by allowing civil society organisations to participate more in planning and budgeting. There are some consultations undertaken when government comes up with policies. A case in point was during the formulation of the National Development Plan, in which key stakeholders participated through various consultative meetings. Decentralisation is progressing, but the issue of funding for local governments remains problematic.

Measures to fight corruption have also been strengthened, with institutions for the investigation and prosecution of offenders being established. Such initiatives have included the creation, in 2008, of the Anti-Corruption Court to handle corruption-related cases, and the creation of a value-for-money Audit Unit in the Auditor General's office to check on government spending at all levels. The government has also formulated a National Anti-Corruption Strategy that will go a long way in streamlining the way corruption cases are handled.

Some corrupt officers have also been prosecuted and others jailed, including those implicated in the Global Fund/GAVI saga. However, there are cases where the government has not matched its commitment to fight corruption with action. For example, the lack of commitment in prosecuting high-level government officials who are suspected of corruption has dented its image. A case in point is the high-profile case where the Security Minister was accused, together with his Finance counterpart, of influence peddling in securing the sale of land to the National Social Security Fund at what was perceived to be an inflated price. Although a parliamentary committee concluded in a majority report that there was wrongdoing, the NRM party and later parliament exonerated the ministers after the intervention of the president. Another case is that of the mismanagement of funds to the tune of USD 500 million that was meant for the preparations for the CHOGM meeting in which the ruling party is accused of complicity to exonerate the culprits, many of whom are senior government officials. Consequently, Transparency International, a global anti-corruption agency, in its *Global Corruption Barometer* report in May 2009 ranked Uganda as the third most corrupt country in the world and the Uganda Revenue Authority as the most corrupt tax body in the East African Community (EAC). These are not the governance credentials of a country run on social market economy principles and there is need for some improvement.

3.6 Regular and Steady Economic Policy

The predictability of economic policy is one of the most important elements of a healthy social market economy. This is because it not only creates a stable environment for actors to do their work but also ensures that the rules of the game are known by everybody and are not changed at the whim of any actor. For the social market economy to work, policies have to be consistent and predictable and the players need to know the rules of the game as put forward in the policy.

3.6.1 Overview of Uganda's policy regimes, recovery and growth trends

On acceding to power, the NRM was first resistant to liberalisation and structural adjustment, but quickly came on board, and has since undertaken what has come to be known as one of the most far-reaching reforms in Africa (World Bank, 2007). The economic reforms have been undertaken in three distinct phases: initial reluctance (1987-1991); acceptance and ownership (1992-1998); and reform consolidation (1999-present).

The NRM's blueprint for economic management on coming to power in 1987 was contained in what they called the Ten-Point Programme that aimed at creating a democratic state that would heavily lead the country's economic development, zero tolerance to corruption, and the devolution of power and resources to local governments (decentralisation). But the economy the NRM inherited was in ruins with very high inflation (about 150 percent) and an overvalued official exchange rate that limited the competitiveness of the country's exports. The fiscal situation was so bad that the foreign exchange reserves barely provided two weeks of import cover and access to loans was very problematic since most banks were almost insolvent.

Consequently, there had been significant economic decline, with growth rates going into reverse. GDP declined by 10 percent between 1984 and 1985 and fell 20 percent from its peak of 1970 (Kasekende and Atingi-Ego, 1999). In response, after initial resistance to the IMF policy prescriptions founded on stabilisation and economic liberalisation and consequent further deterioration of the economy, the government adopted an Economic Recovery Programme (ERP) that was aimed at the promotion of economic stabilisation and long-term growth through mobilising investment in physical assets and rehabilitation of infrastructure.

Some of the policies under this programme were currency reform, devaluations, liberalisation of domestic prices, and the conversion to a floating exchange rate regime in 1993. The next set of reforms involved the adoption of the structural adjustment programme that was meant to free up markets and create price incentives, stimulate private investment, and encourage competition. Reforms under this programme included the abolition of marketing boards, the privatisation and abolition of parastatals and the establishment of the Uganda Investment Authority (UIA).

The outcomes of these policies included the lowering of the annual inflation rate from 190 percent to 28 percent by the end of 1991; the revival of GDP growth rate from negative figures to an average of 6.3 percent per year over 1988-91; and the revival of confidence in the economy that resulted in substantial aid and foreign direct investment inflows and the return of flight capital that supported the country's recovery programme. Most of the economic indicators rebounded from their earlier declines, and by 1996 the economy had only just recovered to its nominal 1971 USD per capita GDP (World Bank, 2007).

The second phase of these reform programmes involved the reforming of the monetary and financial system where a cash budget system to control public expenditure was instituted, ensuring real interest rates on government borrowing through treasury bills, further liberalising foreign exchange allocation and exchange rates, and removing government control over interest rates to improve access to credit (Hölmgren *et al.*, 2001: 122). There were also major structural reforms that included the creation of a semi-autonomous tax body (the Uganda Revenue Authority – URA), the removal of the monopoly of the Coffee Marketing Board and the abolition of the export tax on coffee.

The civil service reform programme that sought to rationalise and restructure government ministries, downsize the civil service establishment through payroll reform and redundancies, and move towards a minimum living wage for civil servants was also undertaken. It is also in this period that the government embarked on an ambitious decentralisation programme where five tiers of local councils were institutionalised with substantial devolution of responsibilities and resources from the central government.

The gains from these reforms were a consolidation of those achieved from the ERP reflected in growth of an average of more than 7 percent (over 3 percent per capita growth), an increase in private sector investment from 9 to 13 percent of GDP, a reduction in inflation to single-digit figures, an increase in foreign exchange cover from two to five months of imports, and a fall in the current account deficit from 6 to 4 percent of GDP from 1992 to 1996 (Hölmgren *et al*., 2001: 123). There were also substantial increases in tax revenues, from a low of 2 percent in 1986 to 12 percent by 1996.

After minimum recovery following the initial policy reforms, the government in 1997 embarked on poverty eradication. In the first phases of the reform process, poverty reduction and equity issues were not the main objective as the government aimed only at growth and macroeconomic stability. But in 1997, the government introduced the Poverty Eradication Action Plan (PEAP), a multi-sectoral programme aimed at reducing poverty. Some of the specific policies in this programme included the Plan for the Modernisation of Agriculture (PMA) that aimed at addressing agricultural constraints to production and commercialising agriculture. The National Agricultural Advisory Services (NAADS), the flagship agricultural productivity enhancement programme within the PMA, targeted the relaxation of marketing infrastructure constraints, technology generation and dissemination, removal of financial constraints, land tenure and policy, formation of farmers' organisations, addressing human resource and information constraints, promotion of on-farm and off-farm storage, stopping environmental degradation, and mitigating the effects of HIV infection and AIDS.

These initiatives were undertaken through a Poverty Action Fund (PAF) that was ring-fenced in the budget with substantial contribution from donors. But owing to the increased use of foreign funds to deliver on PEAP, there was need to rein in the resultant debt. And so reduction in the debt burden became one of the central objectives of government policy. Indeed Uganda became one of the first beneficiaries of the HIPC (Heavily Indebted Poor Countries) Initiative which was a comprehensive approach to debt reduction for the world's poorest and most heavily indebted countries proposed by the World Bank and IMF and ratified by governments around the world. With the programme, the country managed to reduce its debt burden by USD 2 billion under HIPC in 1998 and from the enhanced HIPC in 2000 and successfully rescheduled its remaining debt on much more favourable terms (Dijkstra and Van Donge, 2001). The savings generated by HIPC are directly invested in the Poverty Action Fund, principally for primary education.

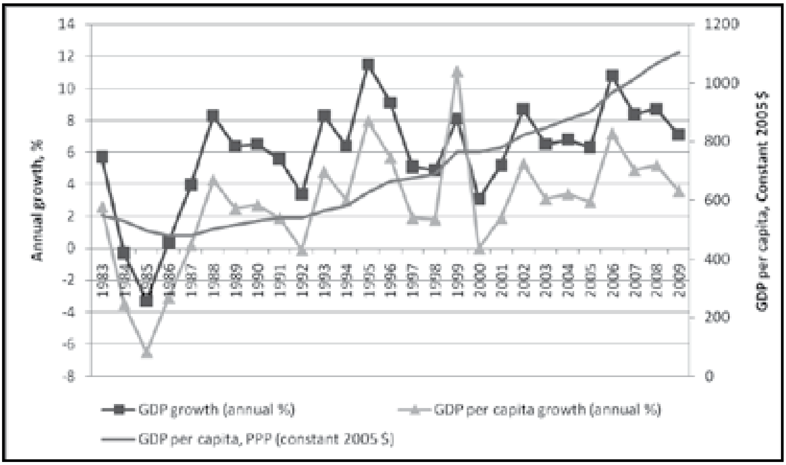
Partly due to the deterioration of public services there was need to increase investments in public services, with government increasing the overall resource envelope for health, education and water and sanitation. One of the major programmes in the set of interventions involved the launch of Universal Primary Education (UPE) by government in 1997 as a means of increasing student enrolment; this resulted in a steady increase in resources for the education sector and an increase in primary school enrolment at the beginning from about 2.7 million to 8.2 million pupils in 2009 (MoFEP, 2010). These reduction measures, coupled with macroeconomic stability and growth, led to sustained reduction in the incidence of poverty from 56 percent in 1992 and this is projected to drop to 24 percent by 2015 (NDP, 2010).

3.6.2 Evolution of the economy during the period 1990-2010

Uganda's economic growth during the past two decades has been impressive by regional and international standards. Economic growth has averaged 7.0 percent a year since 1986 (UBOS, 2009). This growth has mainly been fuelled by comprehensive macroeconomic and structural reforms that were undertaken from the 1990s (Collier and Reinikka, 2001). This growth can be said to have evolved through two phases: the first between 1990 and 1999 and the second from 2000 to 2008. The 1990-to-1999 phase was characterised by sustained positive growth rates far above the sub-Saharan average. At an average of 3.6 per cent, Uganda's per capita income (measured in 1985 international prices) recovered from the low of USD 504 of 1986 and had reached USD 697 by 1997. The Uganda Bureau of Statistics (UBOS) estimates trend growth over this period at about 6.8 percent per year, with all sectors of the economy growing relatively fast during the period 1990-1999.

Similarly, the period from 2000 to 2008 was very impressive. For example, estimates by UBOS show that the average GDP growth rate (at factor prices) for the five years(2003/04-2007/2008) was as high as 7.9 percent, with the economy posting a growth rate of 8.9 percent for the year 2007/2008. This growth has at the same time led to an important structural change in the economy as the share of agriculture in GDP has declined from about 50 percent in 1992 to about 21 percent in 2008 (UBOS, 2008). And as shown above, this growth has been export-led, with the share of exports to GDP rising steadily. Uganda's growth compares well with its regional and international peers, with only Mozambique having posted higher average growth rates (Tables 1 and 2). This growth is even more impressive considering that it has led to increases in GDP per capita despite the country's high fertility rate (Figure 5).[1]

Figure 5: Uganda's annual GDP and GDP per capita percentage growth, 1983-2009



Source: World Development Indicators (2009)

It should be noted, however, that growth numbers per se may be misleading. There have been those who assert that the picture at the micro level has not been as impressive and that this growth has left behind a large section of the population. Indeed most principles of a social market economy can only be satisfied if growth is well shared and affects areas that are more likely to have a bigger impact on marginalized sections of the population. In the proceeding sections we look at the sources of this growth and whether it is consistent with the concept of a social market economy.

1 Uganda has one of the highest annual population growth rates in the world at about 3.2 per cent, or 6.3 births per woman.

Table 1: GDP growth international comparison (annual percent)

Year	Uganda	Sub-Saharan Africa	Ghana	Mozambique	Tanzania	Mauritius	Kenya	Tunisia	South Africa
1997	5	4	4	10	4	6	0	5	3
1998	5	2	5	11	4	6	3	5	1
1999	8	2	4	8	4	3	2	6	2
2000	6	4	4	1	5	9	1	5	4
2001	5	4	4	12	6	3	4	5	3
2002	6	3	5	9	7	2	1	2	4
2003	6	4	5	6	6	4	3	6	3
2004	7	6	6	8	7	6	5	6	5
2005	6	6	6	8	7	1	6	4	5
2006	11	6	6	9	7	4	6	6	6
2007	8	7	6	7	7	6	7	6	5
2008	9	5	7	7	7	5	2	5	4
2009	7	1	4	6	6	2	2	3	-2

Source: World Bank Development Indicator, 2010

Table 2: GDP per capita growth international comparison (annual percent)

Year	Uganda	Sub-Saharan Africa	Ghana	Mozambique	Tanzania	Mauritius	Kenya	Tunisia	South Africa
1997	2	1	2	7	1	4	-2	4	0
1998	2	0	2	8	1	5	1	3	-2
1999	5	0	2	5	1	1	0	5	0
2000	2	1	1	-2	2	8	-2	4	2
2001	2	1	2	9	4	1	1	4	1
2002	3	1	2	6	4	1	-2	1	2
2003	3	2	3	3	3	3	0	5	2
2004	3	4	3	5	4	5	2	5	3
2005	3	3	4	6	4	0	3	3	4
2006	7	4	4	6	4	3	4	5	4
2007	5	4	3	5	4	5	4	5	4
2008	5	3	5	4	4	4	-1	4	3
2009	4	-1	1	4	2	2	0	2	-3

Source: World Bank Development Indicator, 2010

Regarding the sources of Uganda's economic growth, after the war that brought the NRM government to power in 1986, most of the economic growth was driven by the reconstruction of an economy that had almost virtually collapsed. But since 1992 growth has been driven mainly by the services, manufacturing and construction sectors (Table 4). In 2009/10, the share of value added contributed by the services sector was almost half of total gross domestic product (GDP) from about 32 percent in 1990, while that of agriculture diminished steadily from 50.3 percent to about 24 percent in the same period (Figure 6).

The industry sector (manufacturing, construction and mining) share in GDP has increased from about 1 percent in 1990 to about 24.2 percent in 2009/2010. Growth in 2009, as in most of the past, was mainly due to private consumption, with more than 80 percent share of GDP and growing by 11.5 percent. Investment growth was also strong, with public investment rising by an estimated 28 percent in 2009. Private investment growth has been robust but was affected in 2009 by the global financial crisis after growing at 12 percent in 2008. It has recently been led by construction (Table 3).

Table 3: Expenditure on GDP at constant 2002 prices, percentage growth rates

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Consumption									
Private	6.3	6.1	2.8	3.4	8.1	12.3	2.9	8.2	11.5
Public	2.9	5.2	5.2	3.7	4.5	3.7	-1.5	1.7	-1.9
Investment									
Private	10	14.1	16.1	14.6	23.5	10.3	14.6	12.0	1.1
Public	0.3	-8.1	2.3	11.6	9.3	13.5	16.9	-15.3	28.8
Exports	17.2	7	6.6	20.9	21.5	-6.3	53.8	45.0	-12.0
Imports	12.8	7.5	6.2	9.6	16.8	17.2	15.7	17.6	4.6

Source: Statistical Abstract, UBOS

Moreover, economic growth has been export-led, with exports growing strongly for much of the last two decades, declining only in 2009 owing to the adverse effects of the global economic conditions (Table 3). However, the expanding regional market for Uganda’s food has for the last five years boosted agricultural and other regional exports.

Table 4: Sectoral and growth rates at constant (2002) prices

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Sectoral contribution to GDP, %									
Agriculture	23.1	22.1	21.1	20.2	18.3	16.9	15.8	15.1	14.6
Industry	22.0	22.6	22.8	24.0	24.8	25.1	25.1	24.8	25.5
Services	48.3	48.6	49.1	49.0	49.6	49.5	49.9	50.7	50.7
Growth rates, %									
Overall GDP	8.6	6.6	6.8	6.3	10.8	8.4	8.7	7.2	5.8
Agriculture	7.1	2.1	1.6	2.0	0.5	0.1	1.3	2.5	2.1
Industry	7.4	9.5	8	11.6	14.7	9.6	8.8	5.8	8.9
Services	11.0	7.4	7.9	6.2	12.2	8.0	9.7	8.8	5.8
Per Capita GDP	5.1	3.1	3.4	3.0	7.3	5.0	5.3	3.8	2.4

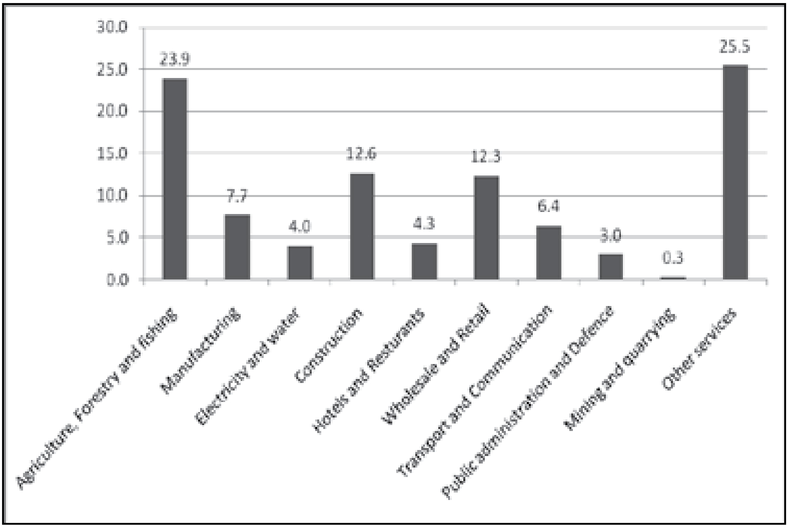
Source: Bank of Uganda, Annual Report 2009/10

The overall impression is that the Ugandan economy has done well in the last two decades even compared to the sub-Saharan average and to other countries in the developing world. The question to be asked, however, is whether this growth conforms to the principles of the social market economy. Can this growth ensure a stable and compassionate society where everybody benefits from the growth or is it skewed towards some powerful interests? Is the growth sustainable or will it unravel in the face of a small adjustment like a recession in the West or a political disorder or cut in aid? The answer to these questions will shed light on whether the economic growth conforms to the tenets of a social market economy.

A look at the distribution of growth shows that it is fairly balanced, permeating all sectors of the economy. But the low growth numbers in the agriculture sector is a point of concern, considering that about 70 percent of the population still live in rural areas and derive their livelihood from the sector (Table 4). The consequence is that growth has left out some sections of the population, especially the rural-based population, and this has implications for social equity and stability. This might negate some of the principles of a social market economy, such as solidarity and common welfare, which require equitable share in growth dividends.

Another element of the recent growth has been the proliferation of the service sector that accounted for more than half of GDP. The problem with this is that most of the service firms are small and employ not more than five individuals. The implication of this is that employment growth does not match growth in the economy. Consequently, employment has lagged behind, resulting in one of the highest levels of unemployment, especially among the youth. This also negates some principles of a social market economy (for example justice, common welfare etc.).

Figure 6: GDP by sector in 2009/2010 (percent)



Source: UBOS, 2009

3.7 Uganda's Monetary Policy

One of the essential elements of a social market economy is monetary stability that is consistent with the fundamentals of a healthy economy. A predictable and stable monetary policy is a major prerequisite for economic growth. This is partly contingent on the competence and independence of the monetary authorities, especially the central bank. In Uganda, the Bank of Uganda (BoU) is the body responsible for monetary policy, whose primary objective is the control of inflation, with the secondary objective of limiting instability in domestic and foreign exchange markets. The central bank uses a combination of sales of treasury bills and bonds, and to a smaller extent foreign exchange, to carry out its sterilisation functions and Repurchase Agreements (REPOs) to smooth intra-auction liquidity.

The BoU has a history of ensuring monetary stability and over the last two decades or so it has been one of the major pillars of Uganda's macroeconomic stability. The taming of inflation from the triple-digit figures of the 1980s to single digits for most of the recent past has had a favourable impact on economic growth and stability and has been a major element in restoring confidence in Uganda's economy. The reasonable independence enjoyed by the BoU has ensured that monetary policy is implemented with minimal interference from government and this has prevented government from derailing the economy with populist policies that would otherwise harm the macroeconomic fundamentals of the economy (for example, printing of money, fixing the exchange rate, over-borrowing etc).

There have, however, been some complaints about incidents where officials of BoU have acted in a way that is inconsistent with the principle of independence, raising questions about whether they can still be relied on as guarantors of the country's monetary policy stability. A case in point is when government has been able to withdraw money from the consolidated fund to bail out businesses of its party supporters without parliamentary approval. This, critics say, puts a dent on the independence of the BoU and raises questions as to whether the bank can be relied on to safeguard the integrity of the economy, considering that such actions may disrupt the economy.

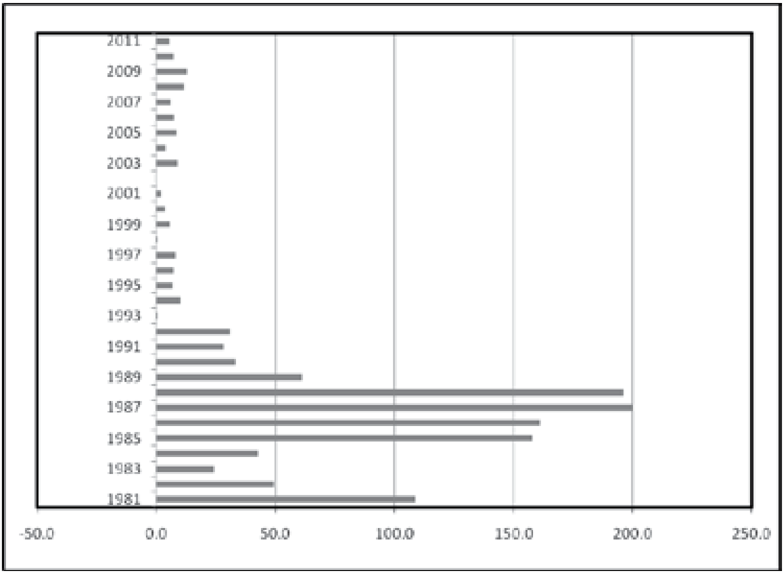
Other incidents that have put the BoU authorities under the spotlight is allowing the government to draw on reserves to fund some activities, such as buying warplanes or funding election campaigns, expenditures that are considered wasteful by many people. The consequences of all these have been that the population is beginning to think that the deterioration of some macroeconomic variables that were hitherto considered under control, such as inflation and exchange rates, could be the result of the poor decisions reflected in the lack of independence of the BoU authorities that allow the government to interfere with monetary policy decisions.

3.7.1 Inflation rate

A stable and low inflation rate is an important element of a healthy economy. One of the reasons the Ugandan macroeconomic policies have been hailed is the ability to tame the inflation rate that by 1987 had reached 220 percent owing to the collapse of the monetary policy and the breakdown of production. Since then, Uganda has remained steadfast on the control of inflation as the overarching macroeconomic policy objective and through monetary and fiscal adjustment; inflation was gradually reduced and kept within single digits for most of the last two decades (Figure 7).

However, the country has recently witnessed inflation at double-digit level, averaging 14 percent in 2009, subsequently falling again to single digits before rising again to the 2009 level in April 2011. Whereas this trend can be partly blamed on external factors, including the increasing international price of crude oil, the increase in food prices and the depreciation of the exchange rate, some critics blame it on government runaway expenditure in the run-up to the recent elections, increasing the cost of administration, expenditure on war-related consumption and other wasteful expenditure. It is, therefore, conceivable that unless the BoU reasserts its independence as the sole authority on monetary decisions, the gains from more than two decades of macroeconomic discipline that have ensured economic growth and stability might be lost. This will dim the chance of Uganda ever becoming a social market economy since an economy whose monetary policy is unstable is inconsistent with the principles of such an economy.

Figure 7: Uganda's annual inflation rate, 1981-2011

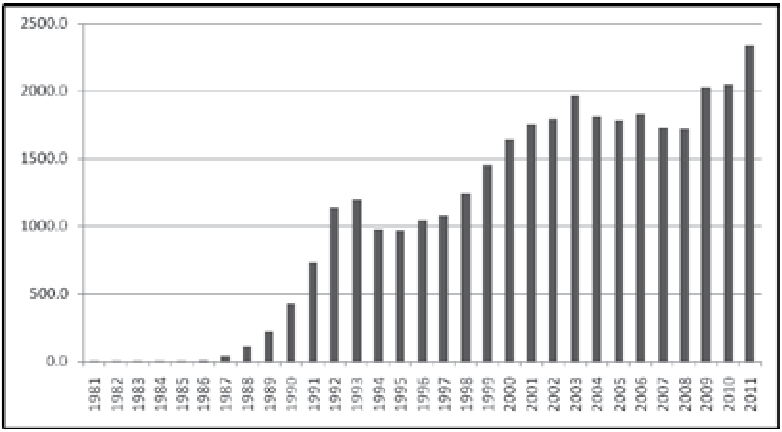


Source: World Development Indicators, 2010 and BOU, 2011

3.7.2 Exchange rate

Following the liberalisation of the current account in 1994, the foreign exchange market got fully liberalised. And since then Uganda has operated a flexible exchange rate, with the Uganda shilling being allowed to fluctuate. But the BoU has always intervened only to mop up excess liquidity. This has ensured that the exchange rate was consistent with the fundamentals of the economy, as opposed to the situation prevailing in the 1980s when the Uganda shilling was greatly overvalued, which hurt the country's competitiveness immensely. Consequently, for most of the last two decades, the Uganda shilling has oscillated around the 1000 to 2000 Uganda shillings mark per one US dollar. However, of late, the shilling has faced serious deprecation pressures, mainly on account of unfavourable terms of trade and lower capital inflows. But some critics blame this on the recent profligate expenditure of the government that has increased the fiscal deficit and government debt, thus undermining the strength of the shilling.

Figure 8: Exchange rate (one Uganda shilling per dollar)



Source: World Bank Development Indicators, 2011

As noted already, this puts the independence of the BoU under the spotlight and to some extent calls into question the capacity of other organs of state, such as parliament and the Ministry of Finance, Planning and Economic Development (MFPED) to tame governmemnt expenditure. Therefore, for the country to maintain its stellar credentials regarding macroeconomic policy, the insititutions charged with setting and implimenting monetary policy have to do their work with independence and minimum interference.

3.8 State intervention in the case of market failure

In a free market, competition is supposed to allocate the resources, and markets are supposed to reach equilibrium. This has been the cornerstone of a capitalist economy but has at some points in time failed to live up to expectations. This has mainly happened at times when the markets have failed and created instability in the economy, often resulting in serious economic disruptions, including the 1930s depression but also the recent global financial crisis. This has led to some critics questioning the whole essence of a free market and to advocate state intervention in the case of market failure.

Indeed, one of the elements of the social market economy is that market actors must operate under free prices, free contracts, free trade, private property rights, private liability, price stability, and predictability of economic policy (market-constituting principles). But the state is supposed to interfere when market power emerges, social costs from inequality arise, the labour supply behaves abnormally, and negative technological externalities occur or positive externalities are under-supplied (regulatory principles). However, if government interferes, it must avoid sectoral interventions, conduct social policy in a market-conforming manner, use stabilisation policy with moderation, and prioritise rules-based over discretionary policy.

What this means is that the state cannot abandon the population to the whims of the market but must come in to correct imperfections in the market that could be affecting some sections of the population. Furthermore, whereas state intervention for most of the last century has been anathema across the western world, it has recently been a hallmark of most of the public policies nations around the world have used to correct distortions in the market and jumpstart their economies in the periods of economic downturn.

This has not only raised the profile of interventionist economists but has also given prominence to economic systems that accept a prominent government role in the functioning of market economies such as the social market economy system. Indeed, this might explain the resilience of the economies that conform to most of the principles of the social market economy amidst the recent economic woes that befell most of the capitalist world economies. Germany, for example, is one of the western countries that very effectively weathered the recent economic crisis, maintaining its robust export market, and this can be partly credited to its applied model of a social market economy.

The government role in correcting market imperfections cannot be overemphasised, and it should follow that countries that keep their hands off economic policies may run the risk of suffering from market imperfections. This has been a major problem for developing countries, including Uganda that implemented the IMF- and World Bank-supported Structural Adjustment Programmes (SAPs) that largely discouraged government intervention, preferring a free market where resources are allocated on a competitive individual basis.

This has created a dilemma for these countries. Often the multilateral institutions, such as the World Bank and IMF, and even bilateral donors set minimum or total non-state intervention as a condition for fiscal support, and countries are forced to abide by these conditions because of pragmatic considerations.

This has often created a situation where, even in the face of economic difficulties arising from market failures, the state avoids any form of intervention, resulting in economic and sometimes social disharmony. This has in some cases led to social tensions as those sections of the population left out of the market clamour for a 'piece of the cake'. In Uganda, for example, the liberalisation of the economy in the 1990s opened up many opportunities for some but also left out a lot of people who are now considered very vulnerable.

The recent underperformance of the agricultural sector is considered to be partly a consequence of the abolition of price stabilisation measures that used to support farmers in times when agricultural commodity prices fell too steeply. This was aggravated by the collapse of cooperative societies that had hitherto helped farmers in marketing and offering subsidies and credit, services that are now left to the private sector. This has left farmers exposed to the vagaries of the market where they are often cheated by middlemen.

Another consequence of liberalisation and the SAPs is the privatisation of most of the government parastatals that used to provide jobs and cheap goods and services to the population. Largely owing to the failure of government firms and the debt burden the government was carrying from subsidising them, under the tutorage of the IMF and the World Bank, most of these parastatals were privatised and some liquidated. The problem that resulted is that the new owners were mainly motivated by profits and the goods and services that were hitherto subsidised by government are now provided at market prices which are out of reach to most of the population. The result of this has been that large sections of the population cannot access most goods and services, some of which are considered to be essential for any person.

It is also a well known fact that the private sector is not good at providing public goods and, in the case of Uganda, where most providers of these goods are now private, this has created a situation where most poor people cannot access these goods and services because they are out of their reach. In cases where government tries to provide these goods and services, such as with public health and education, there is always conflict of interest where providers, like teachers and doctors, play the double role of providing these services in their private businesses and also working for government.

This state of affairs has created problems mainly on two levels. First, public service provision has deteriorated because of the profit motive of the providers and because government oversight has been very limited. Second, the market has hindered the very vulnerable in society, especially the poor, from accessing even the most basic of the services like health, education, water, electricity etc.

Furthermore, government, wary of policy reversal, has been reluctant to intervene in cases where the population has been left to the mercy of the market and the private sector. A case in point is the recent increase in food and fuel prices that is causing disquiet in the population, and even social unrest. Whereas it can be argued that the increases are a result of external forces, namely the high international prices of oil and food, it can also be – at least to a certain extent – argued that this is a result of the government's hands-off approach to the economy. The government has resisted all pressure to intervene and try to bring down the prices, arguing that this would amount to interventionism.

But whereas it is understandable that in a free market, prices should be set by the market, it cannot be denied that the market is sometimes cruel to the vulnerable and government should always be ready to intervene on their behalf. Therefore, having liberalised the economy and ensured minimum recovery and impressive growth rates for the last two decades, the government should reassess its stand concerning intervention in the economy. Leaving the people to fend for themselves even when it is clear that there is market failure is not sustainable and may lead to social instability.

3.9 Uganda’s Fiscal Policy

A prudent fiscal policy is a major element in macroeconomic stability, ensuring that government mobilises enough resources which it then spends in a way that leads to economic growth and improvement in the welfare of the population. The main fiscal objectives of a healthy economy are to maintain macroeconomic stability, such as keeping inflation low, and a competitive exchange rate for the export sector, while at the same time increasing the resources allocated to those areas that increase the productivity of the economy, such as infrastructure development, including roads and energy.

The fiscal policy consistent with the principles of a social market economy is that which ensures that the economy is financially sustainable without relying too heavily on debt and is responsive to the needs of the people, including the vulnerable. Expenditure is targeted at areas that generate economic competitiveness and enhance societal welfare. In the case of Uganda, resource mobilisation has often lagged expenditure, partly owing to the economic collapse that characterised most of the post-independence period. Consequently, there has always been a wide gap between revenue and expenditure, necessitating the use of external financing to cover the resultant budget deficit (Figures 9 and 10). For example, whereas in 2009/10 the share of total government expenditure to GDP was 18.3 percent, that of revenue to GDP was just 15.4 percent. Consequently, the fiscal deficit, including grants, is estimated at 3 percent of GDP. The high external support to the budget runs counter to the principles of a social market economy, particularly subsidiarity which requires a degree of self-reliance, which the Ugandan economy has not shown. However, the percentage of external support as a share of GDP has been decreasing, giving the hope that the economy might in the near future be self-sustaining (Table 5).

Table 5: Selected indicators of central government operations (percentage of GDP)

	2004/05 Outturn	2005/06 Outturn	2006/07 Outturn	2007/08 Outturn	2008/09 Outturn	2009/10 Budget	2009/10 Estimate
Revenue and grants	22.2	17.7	18.0	16.3	15.5	16.5	15.4
Domestic revenue	13.8	12.7	12.8	13.3	12.6	12.9	12.7
Tax revenue	13.6	12.3	12.4	12.9	12.2	12.7	12.5
External Grants	8.5	4.9	5.1	3.0	2.9	3.6	2.7
Total expenditure (excluding domestic arrear repayments)	23.1	19.2	18.7	17.6	16.4	20.0	18.3
Gross operation balance	3	1.1	1.5	0.9	1.7	0.6	0.3
Budget deficit (excluding grants)	-9.8	-6.8	-7.0	-4.9	-4.6	-7.2	-5.7
Budget deficit (including grants)	-1.3	-1.9	-1.7	-1.9	-1.7	-3.6	3.0

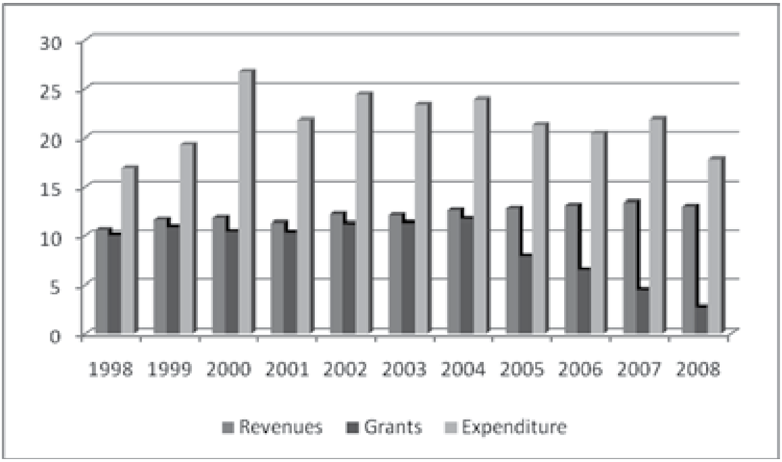
Domestic financing	-0.5	-0.4	1.2	1.0	0.3	-0.9	-1.2
Donor assistance	10.5	7.5	9.0	4.9	5.3	7.2	5.0
External borrowing	-0.9	-1.5	-3.2	-1.4	-1.9	-3.0	-1.8

Source: Ministry of Finance, Planning and Economic Development (2010)

However, this will only be possible if the government expenditure priorities are good, such that resources are not put into unproductive areas. Otherwise, unnecessary or unproductive expenditure will not help the economy to generate enough revenue to match the expenditure. The government would then be forced to rely more on external grants and, worse still, on borrowing.

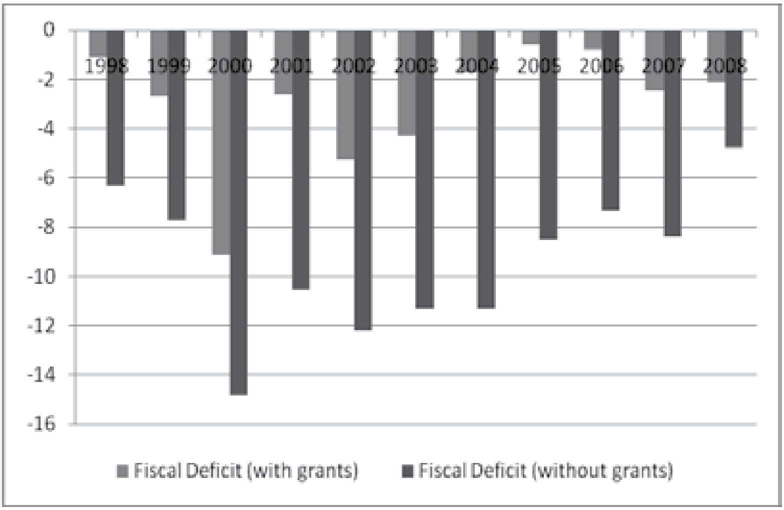
This in the past has created a huge debt burden that was at one time quite unsustainable, until it was released under the HIPC Initiative that cancelled most of the debts (Figure 11). Since then the country's debt has been sustainable, maintained at less than 20 percent of GDP. But it has recently started to climb again, partly because of the recent expansionary expenditure as the country ramps up investments in infrastructural development, especially power and roads. If this debt continues to climb and becomes unsustainable again, it will be difficult for the country to achieve the government-stated aim of turning the country into a middle-income economy. Such debt is also inconsistent with the principles of a social market economy. This is because an indebted country cannot conform to the principles of a social market economy, especially the subsidiarity principle. Self-reliance is the cornerstone of a properly functioning social market economy, and a country that sinks into debt cannot be said to be self-reliant.

Figure 9: Revenues, expenditures and grants (percentage of GDP)



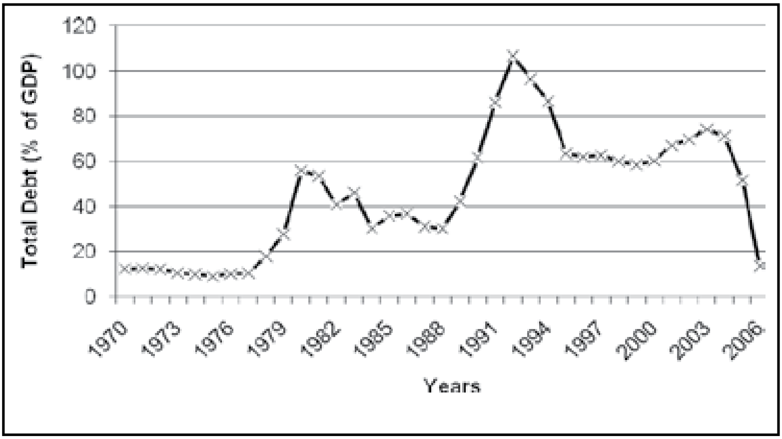
Source: MoFPED, Background to the Budget, various issues

Figure 10: Budget deficit including and excluding grants (percentage of GDP)



Source: MoFPED, Background to Budget, various issues

Figure 11: Uganda's total debt (percentage of GDP) 1970-2006



Source: World Development Indicators

3.10 Social Balance and Social Security

The whole essence of a social market economy is that it should create a social balance by catering for those who are vulnerable. Those individuals who are left out owing to the harsh economy are helped by either individuals or the community that have the ability, or the government comes in to intervene on their behalf. The result is a stable society that generates resources from able individuals and uses those resources to support those who can no longer support themselves or those who, because of inadequacies imposed upon them by external forces, are not in control of their lives. The result is a society in which individuals work hard when they have the ability and contribute to society but in which there is the community and government to turn to when they cannot sustain themselves. One way to ensure that resources to look after societal needs are mobilised is through taxation, which plays a big role in a social market economy.

3.10.1 Tax policy

Uganda's tax system has passed through a number of phases and faced a number of challenges since 1980. In the 1980s, most of the country's taxes came from exports which made up between 15 percent and 68 percent of all the taxes. But this had a debilitating impact on the country's exports, calling for tax reforms that could improve revenue collection in a sustained manner. One of the most outstanding reforms was the creation of a semi-autonomous revenue agency, the Uganda Revenue Authority, URA to collect tax revenue on behalf of the central government, but this was in the mid-1990s followed by the introduction of VAT to replace sales tax and Commercial Transaction Levy (CTL), and the enactment of a new Income Tax Act (ITA) (1997) to replace the Income Tax Decree (1974). These tax reforms partly contributed to the increase in the tax-to-GDP ratio to 13.6 percent by the end of 2003/04, from its low level of 7.8 percent in the pre-reform period.

Taxes are frequently classified as 'direct' and 'indirect'. Personal taxes, such as the individual income tax, are direct and most taxes on goods and services, such as sales and excise taxes are indirect. Uganda collects both these types of taxes. Direct taxes include Pay as You Earn (PAYE), withholding tax and corporate tax, while indirect taxes include excise duty, sales tax and VAT. Uganda heavily relies on indirect taxes but the share of direct taxes has been growing.

The dilemma that policy-makers usually face is not only that of determining the appropriate tax mix between direct and indirect taxes but also of determining the objectives of the tax system. There are usually conflicting objectives of either efficiency or equity. The American Institute of Certified Public Accountants (2001) lists 10 guiding principles of good tax policy as: equity and fairness; certainty; convenience of payment; simplicity; neutrality; economic growth and efficiency; transparency and visibility; minimum tax gap; and appropriate government revenues. The guiding principles are commonly cited and used as indicators of good tax policy. All the guiding principles have been selectively emphasised in Uganda. But ultimately what matters is that the government collects as much revenue as possible with minimum impact on the welfare of the people and with enough safeguards to compensate those that may be negatively affected by the system.

As mentioned earlier, domestic indirect taxes are a major source of government revenue (approximately a quarter). However, these taxes are consumption taxes and impact considerably on the welfare of the people, especially the poor. Indirect taxes in Uganda are of two types, VAT tax and excise tax.

VAT is levied on most transactions at a uniform rate of 17 percent and is implemented with few exemptions (such as health, education, transportation etc) and zero-rated (unprocessed food items) goods/ services. Whereas it is an indirect tax on consumption and therefore assumed not to impact investment and exports negatively, it is a wide-ranging tax and payable by both the rich and the poor. Conversely, excise tax is not as broad-based as VAT, with only a few items such as alcoholic and processed soft drinks, and petroleum products being subjected to excise duties. This makes excise taxes more progressive. However, there are other factors that are taken into account in designing a tax system.

Apart from the issues of efficiency and equity of the tax system, there are issues of effectiveness of the system in generating enough resources to fund the budget and deliver the public goods that are needed by the state. A respectable state should be able to deliver public goods from the mobilised revenue in order to enhance human capital and the wellbeing of communities, as well as stimulating investment and employment creation by the private sector.

However, Uganda's tax system has not raised sufficient revenues to finance essential government expenditure and the level of donor support has been significant. For example, although the tax-to-GDP ratio, which was a dismal 6.5 percent in 1989/90, had increased to about 13 percent in 2010, the ratio is still below the sub-Saharan African average of about 20 percent. Part of the problem is that a large section of the economy is untaxed, especially the informal and the commercial agricultural sectors, which complicates efforts to widen the tax base and increase domestic revenue.

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

The gap between revenue and expenditure creates a serious financing problem for the country that necessitates the use of external financing to cover the resultant budget deficit. For example, whereas in 2007/08 the share of total government expenditure to GDP was 17.1 percent that of revenue to GDP was just 13.5 percent (Figure 9 and Table 5). Moreover, this fiscal deficit (excluding grants) has been increasing, from about 6.5 percent in 1997/98, peaking at 13.6 percent in 2001/02, before falling to 6 percent in 2010/11, owing to the various debt release initiatives and the commitment of the government to finance most of the budget through domestic revenues (MoFPE, 2010). This has a major impact on the principle of subsidiarity that nations that would like to implement a social market economy need to adhere to. Uganda needs to broaden its tax base if the principle of subsidiarity is to have meaning to the country and its citizens.

Table 6: Percentage share of taxes in the overall tax collections, 2002/03-2006/07

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

Source: UBOS, 2009

The country has quite a narrow range of taxes, with most of the revenue coming from indirect taxes (Table 6). Except for income tax on those employed in the formal sector, there are few other income taxes and the rich may be escaping with untaxed income. The other tax policy issue that is relevant to the proper functioning of the social market economy is the welfare impact of the tax policy, especially on poverty reduction. Studies have found that taxes have a disproportionately negative impact on the poor. For example, Matovu et al. (2009) found that taxes on foods, especially staple foods, have an adverse effect on the poor. The results of studies by Ahmed and Stern (1991), using the Marginal Social Cost (MSC) approach, and by Ssewanyana (2009) found that taxes on fuels such as kerosene or paraffin are regressive and have a high social cost. Furthermore, Davis (2007) found that poorer taxpayers are disproportionately burdened by excise taxes imposed on 'necessities', such as gasoline, utilities and telephone services. In Uganda, metered water, electricity and telecommunication services are VAT-eligible. In addition, telecommunication services attract excise tax, implying that the urban poor are disproportionately burdened.

As noted earlier, one of the most important tax reforms undertaken by government was the introduction of VAT. It is, therefore, important to assess whether this in welfare terms was a wise move. A number of studies have found that the introduction of VAT was a progressive move. For example, Matovu et al. (2009), using the Computable General Equilibrium (CGE) simulation model, found that the removal of VAT improves the welfare of richer households and leads to the decline in welfare of the rural households, the implication being that the replacement of sales tax with VAT did not make the poor worse off. Therefore, considering that VAT and excise taxes, which are some of the main taxes in Uganda, do not place much burden on the poor, and the fact that most poor people do not pay direct taxes, it is safe to say that Uganda's tax system is generally pro-poor in terms of equity.

The problem generally arises on the expenditure side, with the taxes that are collected being used inefficiently. This, coupled with tax evasion and a narrow tax base, limits the effectiveness of the public service delivery system. Mobilising taxes without showing clearly how past taxes were used is always a disincentive for further tax efforts. This is important as citizens become more receptive to paying taxes when they can make a direct linkage between taxes paid and public services. Thus, government needs to include details of how tax revenue was used in the previous year in the budget - outlining what projects were undertaken, at what cost, as well as the quality and benefit of such projects to the economy. This can be achieved by improving the efficiency of public spending across ministries and agencies. This is also a major element of the social market economy and it feeds well into the subsidiarity principle.

Social policies, including tax policy and social protection measures, also have implications for pro-poor growth. The question of pro-poor growth is at the centre of the benefits of a social market economy. It shows a system that is free, competitive but also compassionate. Indeed most of the principles of a social market economy, notably justice, solidarity and responsibility, tie in well with the aims and outcomes of pro-poor growth. Therefore the question one would want to ask is whether Uganda's growth has been pro-poor or not. Pro-poor growth here means growth that 'enables the poor to actively participate in and significantly benefit from economic activity'; this is the so-called direct pro-poor growth (Kakwani and Pernia, 2000). Such growth should be able to immediately raise the incomes of the poor, or to favour those sectors and/or regions where the poor are employed, and use the factors of production they possess. In Uganda, considering that the majority of the people live in rural areas, growth is also likely to be pro-poor if it is strong in agriculture, in non-farm rural activities, and in informal sector activities. It also should be labour-intensive and land-intensive, and it must be concentrated in localities with high poverty rates.

However, recently growth rates in agriculture have been low and this seems to have left out especially the rural poor, who depend on the sector. In the light of the importance of agricultural performance in poverty alleviation, the lack of sustained agricultural growth and the apparently slow process of diversification in agriculture pose a serious threat to poverty reduction efforts and this may make the achievement of a social market economy for Uganda – if wanted - very difficult. Whereas the reforms of the early 1990s, especially the dismantling of the agricultural parastatals and liberalisation, brought high growth rates, this was sustained for only a decade until the static efficiency gains had been exploited, with the gains being shared equally by the population engaged in agricultural activities.

But since the mid-1990s, the economy has largely shifted in favour of only a small fraction of farmers, namely the richer and better-educated farmers who have been able to diversify their agricultural production. Consequently, only 50 percent of agricultural production is sold on markets, with most smallholders, except coffee farmers, and those engaged in other tradables or niche markets (vanilla, fruit, tomatoes), still being engaged in subsistence farming. But 80 percent of the households that were chronically poor are still peasants engaged in self-employment and subsistence activities (Kappel *et al.*, 2005).

This has gravely affected the rural poor and left them out of the mainstream economic activities, which has made growth, especially in the later years, not pro-poor. Evidence from household surveys shows that, owing to the impressive economic growth through the 1990s, the Ugandan population experienced important broad-based welfare gains in terms of consumption increases. In recent years, however, only the rich have benefited from growth and large parts of the population have experienced drastic declines in welfare levels, according to analyses by Uganda National Household Surveys (UNHS) for 1990/91, 2002/2003, 2005/06. Moreover, the consumption gains were not equally distributed across the country, with average growth being higher in urban than in rural areas, thereby increasing already existing disparities. There were also sharp regional disparities in growth and poverty reduction, with most gains occurring in the central region while the North lagged far behind. For example, whereas poverty rates decreased from 46 percent in the central region in 1992 to 27 percent in 2006, the rates on the other hand decreased only marginally from 73 percent to 66 percent for the northern region in the same period.

Furthermore, growth seems not to be fundamental in the sense that the population stills feels vulnerable and insecure, for two reasons: first, poor households were not able to accumulate productive assets, which could sustain higher consumption levels, and some households apparently had to sell off some of their assets; and second, because of serious natural resource degradation and environmental shocks that threaten food security for many households. Moreover, in spite of the growth and some progress in the public domain, gender inequality still persists, and as the economy changes and women's workload increases, their situation becomes worse. Nevertheless, in spite of these challenges, especially the various disparities, and the perceived vulnerability and insecurity mainly due to lack of asset accumulation, Uganda's growth is still considered pro-poor owing to the improved standards of living of the people that has resulted from this growth (Kappel *et al*., 2005; Okidi *et al*., 2007). However, considering this recent increase in inequality and disparity in poverty reduction, the past gains may be in danger unless efforts geared at lifting sections of the population that have been left out are explored and investment in the assets of the poor is accelerated.

3.10.2 Social security system

Three principles of a social market economy, namely justice, solidarity and responsibility, are at the heart of the social security system. Social security recognises that whereas individuals should work hard for their sustenance, there are social factors that may threaten the security of some that are out of the individuals' ability and which may need a social response.

Often in market economies, individualism may breed vulnerabilities when individual efforts fail to provide enough sustenance to some people or communities. Social security comes in to alleviate the burden of providing one's welfare in conditions of need. Indeed for the vulnerable, apart from one's own savings and the private pension obtained from one's employer, social security is another key pillar for relieving deprivation and providing for retirement. But for most Ugandans there is not much access to formal social security.

As of now, the law that governs social security is the National Social Security Fund Act 1985 established after the repeal of the Social Security Act 21 1967 and the Social Security (Amendment) Decree 33. This act requires employers to register their organisations when they employ more than five people. All employees between the ages of 16 and 55 are required to be members of the NSSF. The act requires a total contribution of 15 percent of an employee's monthly wages, 10 percent from the employer and 5 percent from the employee. NSSF is a national saving scheme for workers and provides benefits to cover contingencies such as old age, invalidity and death. But for most Ugandans, especially the self-employed, low-income earners, women, part-time workers, and workers in small enterprises of fewer than five permanent employees, this law is not mandatory and many Ugandans are not obliged to mobilise such savings either through compulsory contributions or voluntary savings. The culture of saving is also very low, partly because disposable incomes for most Ugandans are too low. Consequently, sustenance on a 'rainy day', such as upon retirement or in case of sickness or disability, is a nightmare for most Ugandans.

In the light of inadequate savings and low income levels that are available to average Ugandans, the importance of social security to lifelong wellbeing cannot be overemphasised. The law that gives the NSSF the monopoly over all workers' savings and limits savings to private pension schemes makes the situation even more untenable. There is urgent need, therefore, for the streamlining of the social security sector not only to create competition but also to allow for more innovative ways of savings mobilisation.

As a monopoly that caters for all formal workers in the country, the NSSF has been at the core of the government's social security. Contributions to the fund are paid monthly at a fixed rate and require the employer to deduct 5 percent from the worker's gross wage and to top it up with own contribution of 10 percent. The NSSF then invests in ventures that it thinks can yield dividends for the workers, such as government stocks, bonds and fixed deposits with banks and in estates. This has made the NSSF one of the richest organisations in the country. But the coverage of the NSSF is limited, considering that it registers only those employers in the formal sector with at least five employees.

The benefits that are payable to members include: Age benefit payable to members who have attained the age of 55 years, whether they are still working or not; withdrawal benefit payable to a member aged 50 years who has been out of work for a period of 12 months; invalidity benefit payable to members so disabled and incapacitated that they are unable to work as a result; survivors' benefit payable when a member dies; emigration grant payable to the member who is leaving the country permanently. However, in a country with no prudent accountability standards, handling such huge sums of money has raised issues related to trust, with clients not being sure that their savings are safe. This has been aggravated by cases of corruption where government officials, in collusion with some fund managers, have misappropriated savers' money and/or made poor investment decisions that have led to losses.

The state of social security in Uganda has, therefore, been of concern and led to calls for the liberalisation of the social security system. A law to that effect has been in the works for some time now but has been vigorously opposed by officials of the NSSF for what some people may call selfish reasons as that may break their monopoly. It could also be argued that government may be dragging its feet on the legislation partly owing to the fact that the large sums held by NSSF may be an easy target for government officials who may want to misuse it. But partly because of the limited coverage of the formal social security system (NSSF), as has been the case in Uganda for a long time, family and other traditional social support systems like tribe, village, class, or community are the most important social security providers in the country.

Moreover, whereas the emergence of urban commerce and formal employment has led to labour mobility and subsequent disintegration of kinship and extended family systems, these systems still provide the best recourse for most vulnerable groups. However, modernised practices such as education and urban employment still pose challenges to these traditional non-formal security systems. For example, they take away sons and daughters who would normally care for the aged.

In spite of these challenges, however, the persistence of the bond between rural and urban dwellers and the continuation of informal and semi-formal ties between groups of people has ensured that traditional social cohesion and support remains an important aspect of Ugandan society. The semi-formal social security schemes are formed with the aim of benefiting from mutual help in vulnerable situations and have traditionally provided services ranging from funeral, marriage, and school fees contributions to any other support that may be agreed upon by the members. One reason these support systems are still popular is because they are considered to be friendly and personal (Kasente *et al.,* 2002). They are also considered to be easy to access without much or any need for paperwork and application procedures.

It should also be noted that even those benefiting from formal social security systems still have semi-formal and informal arrangements they fall back on to provide for their social protection in most pressing eventualities, such as the death of relatives. Community groups are the most prominent and widespread and the contingencies they cover vary from place to place, but many individuals belong to all types of groups at the same time. The prospects for improving social security services will depend largely on support services targeting grassroots self-help community-based organisations. What is required is the strengthening of their social and institutional capacity and focusing on poverty eradication through these organisations. Liberalised markets will not fill this gap without massive subsidies.

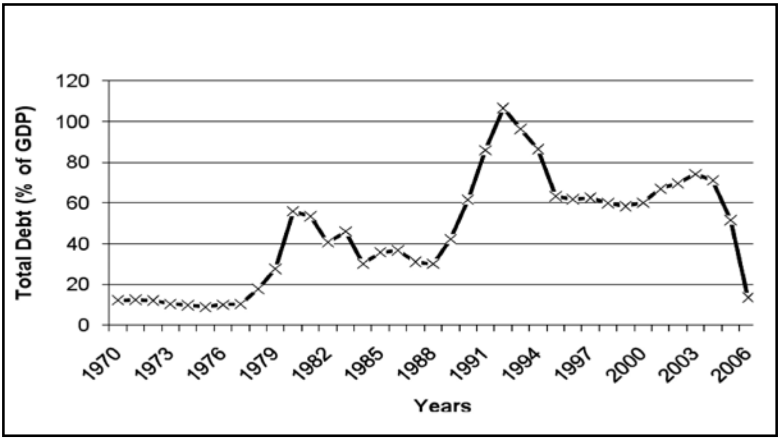
3.11 Provision of Public Goods by the State

One of the most important roles of the state is the provision of public goods to the citizens. This is very important because the private sector and the market are not usually the best providers of these goods partly because of the non-exclusivity of these goods. This is also a major element in a social market economy, where government efficiently provides public goods and services to the citizens without leaving this role to the private sector alone. Uganda has through the years tried to provide public goods to its citizens but the record has been mixed. In order to encourage countries to focus more on providing public goods and services to their citizens, especially the poor, in 2000 the international community, through the United Nations, came up with the Millennium Development Goals (MDGs) to be met by 2015, where governments were supposed to accelerate investment in mainly social services. Most of these goals were actually aimed at increasing access by the population to public goods and services that had suffered immensely when most poor countries adopted the SAPs.

The level and distribution of public spending also has implications for pro-poor outcome and unless expenditure is targeted at areas that impact the poor, it will not lead to optimal outcomes as far as the poor and other vulnerable groups are concerned. Starting in the late 1980s and early 1990s public spending in Uganda was largely aimed at macroeconomic stability, which necessitated keeping public expenditure low. But in the late 1990s and the 2000s policy shifted to poverty reduction and the improvement of the social indicators of the country, and this came with substantial increases in public expenditure, especially going to social sectors (Figure 12). Examination of the composition of the public budget for the period shows that spending on education and health increased from 15 to 18 percent of total expenditure during the period 2001-2008 (Table 7).

However, expenditure on other social services, such as water, has generally remained low over the same period at 0.1 percent of the total budget. Consequently in the PEAP framework, several poverty priority areas for public spending were identified, including primary education, primary health care, road rehabilitation and maintenance, agricultural modernisation, and water and sanitation. With the national commitment in 2000 made in the wake of the Millennium Development Goals summit in the United Nations General Assembly, the focus of public spending became more geared to delivering on the MDG goals.

Figure 12: Gross public expenditure per GDP, 1990-2008 (expenditure and GDP in billion UGX)



Source: World Development Indicators 2010

In line with those commitments, in 1997, one year after Uganda qualified for the HIPC, it introduced the Poverty Action Fund (PAF) to help channel savings from debt relief, as well as donor contributions and government's own resources, towards priority areas of spending that came to coincide with expenditure on MDGs. Consequently, priority areas under PAF including primary education, primary health care, road rehabilitation and maintenance, agricultural modernisation, and water and sanitation, and later, HIV/AIDS treatment and prevention, micro-finance, cattle restocking, adult literacy, environmental protection, and accountability measures, were emphasised for their perceived potential impact on the realisation of the MDGs.

Table 7: Functional classification of government expenditure

Function classification	**`00/01**	**`01/02**	**`02/03**	**`03/04**	**`04/05**	**`05/06**	**`06/07**	**`07/08**	**`08/09**
Public administration	33.6	25.2	18.1	10.3	17.4	25.2	39.2	36.9	24.3
Defence	22.5	19.7	20.4	10.5	24.5	23.1	21.6	21.2	25.8
Order and safety	10.4	9.2	10.6	4.6	10.7	11.6	12.8	12.6	12.7
Education	11.6	10.5	9.2	4.2	8.4	7.6	14.7	12.9	16.6
Health	4.1	4.8	6.1	2.5	5.3	5.3	3.9	5.5	7.3
Community and social services	1.5	0.8	0.8	0.3	0.6	0.5	1.2	1.7	1.1
Economic services	1.0	1.1	1.1	0.3	0.8	1.7	1.2	1.6	3.0
Agriculture	0.8	0.7	0.7	0.2	0.7	0.9	1.2	1.8	2.9
Roads	1.7	1.9	1.9	0.6	1.5	1.8	4.0	5.5	6.1
Water	0.1	-	0.1	0.0	0.1	0.1	0.2	0.2	0.2
Loan repayment	8.6	12.0	25.7	66.3	24.9	16.0	-	-	-
Other functions	2.4	10.7	0.3	-	-	-	-	-	-
Pensions	1.8	3.5	4.7	0.1	5.3	6.3	-	-	-
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: UBOS statistical abstracts (several years)

This emphasis on spending on MDGs is reflected in the fact that about three-quarters of these PAF resources are channeled to local governments, which also implement most of the PAF programmes, and the fact that PAF funds are protected from potential cuts in the budget (Williamson and Canagarajah, 2003). Consequently the share of the PAF in total public expenditure has risen over time from 15 percent in 1998/99 to about 32 percent in 2008/09. Therefore, there has been continued targeting of government expenditure towards areas that can impact the poor and help improve prospects for achieving MDGs. Studies which have been conducted to estimate the resource requirements to meet the MDGs by 2015 find that there is need for considerable scaling up, with additional spending required depending on the form of financing, ranging between 11 and 16 percent of GDP per year (Matovu *et al.,* 2010).

Whereas it is clear that pro-poor spending increased tremendously over the last two decades, it is helpful to find out whether such spending and the accompanying policy reforms succeeded in improving the welfare of the poor. It is also important to assess whether this expenditure has conformed to the principles of a social market economy. Benefit incidence analyses to determine the distribution of the benefits from public spending may be particularly illuminating. These studies indicate who gains from public services and describe the welfare impact on different groups of people or individual households.

Benefit incidence analysis studies have shown that, as a consequence of increasing resources to primary education, primary health care, feeder roads, protected water sources, and agricultural extension services over time, poor people's access to most of these public services has improved. These studies, however, found that access to primary health care and extension services is still insufficient and that serious quality concerns still prevail for all the above five areas (see for example Kappel *et al*., 2005).

Household survey evidence shows that the share of 7- to 13-year-old children who were not enrolled in school decreased dramatically between 1992/93 and 2002/03 and the poor, who were previously the majority among those who did not attend school, benefited significantly from the policy. With regard to gender inequality, the survey shows that on average gender bias, which existed before UPE was introduced, has been eliminated by the UPE policy. Consequently, whereas in 1992/93 considerably fewer female than male children were enrolled in school, regardless of their socioeconomic background, by 2002/03 there was no longer any such clear-cut division.

Therefore it can be inferred that public spending on primary education has a pro-poor distribution in the sense that children from poorer households benefit more than children from richer households, but that does not hold for tertiary education[2] as benefits accrue mostly to children from richer households, with the richest 20 percent of the population receiving about 60 percent of public subsidies in tertiary education, especially at university level. This pro-rich bias of tertiary education seems to temper the pro-poor benefits accruing from UPE, thereby making public spending on education in totality non pro-poor.[3] Considering that expenditure on primary education does not seem to significantly improve the ability of the poor to improve their (self-)employment situation, it might be imperative to intensify public funding of especially tertiary education (or reduce the bias in favour of the rich) so as to make education policy more pro-poor.

Except for primary health care, public expenditure on health, especially that on hospitals is not pro-poor. Actually, the share of ill or injured people who did not receive any medical attention amounts to 14 percent in the poorest quintile in 2002/03 compared to only 3.8 percent for the fifth quintile with access to health services (Kappel *et al.*, 2000).

Moreover, most people, both poor and rich, prefer private to public health facilities, with the richer people being more likely to attend private facilities, mainly because of the poor quality of public health services. The poor services are mainly the result of inadequately qualified and motivated staff and the diversion of drugs to private practices. This affects more acutely the rural areas, which cannot compete favourably with urban areas for the limited number of medical staff in the country. Consequently, it is the poor (and women), who mainly live in rural areas, that benefit least from public expenditure on health.

2 The conclusion made for UPE may as well be made for Universal Secondary Education (USE) since the two programmes were modelled similarly, although this study did not handle the latter because it was not yet in operation.

3 USE is thought to have helped make education spending more pro-poor.

As for access to clean water, whereas as of 2002/03 more than two-thirds of households had access to drinking water, the richer the household the more likely it is to use protected water (tap or piped water) and the less likely it is to use water from boreholes. Nevertheless, the policy of increasing water provision, especially in semi-urban and rural areas, has helped mostly the poor who had limited access to safe water. As far as policies targeted at developing especially smallholder agriculture, such a PMA and its flagship policy, the National Agricultural Advisory Delivery Services (NAADS), are concerned, there is a feeling that they have not helped the poor as they had been intended to. Not only does agriculture receive the least amount of public resources (slightly above 4 percent of PAF resources in 2008/09) of the five priority areas under PAF, even the spending seem to go to the relatively well-off at the expense of the poor. This is reflected in the large number of poor farmers who say that no extension staff visits them and complaining that they are discriminated against.

In summary, the policies that were initiated to help reduce poverty and improve social indicators for the poor have had mixed results for the intended beneficiaries. Whereas some policies, such as UPE (and USE) and primary health care, have clearly been pro-poor, the poor services being offered may have tempered these benefits. Moreover, some policies, such as limited public support to tertiary education and dysfunctional agricultural extension services, may have actually been pro-rich and might need revision and/or reorientation if they are to help the poor as intended.

4 Applicability of Social Market Economy Principles in Uganda

Uganda has in the recent past been credited with creating a favourable macroeconomic environment that has grown the economy. However, these policies have often been criticised for leaving some sections of the population out in the cold. In contrast, however, countries like Germany that have implemented the social market economy system are famous for inclusive growth and development. It is, therefore, important to assess Uganda's policy regime to ascertain how it conforms to these positive principles of a social market economy and also find out whether these good attributes of the social market economy can be adapted to the Ugandan situation. The idea is to create a more balanced economy that caters for all Ugandans.

4.1 Ugandan Policies and their Adherence to Social Market Economy Principles

As explained above, Uganda's record on following the principles of the social market economy in its policies is mixed. Whereas some principles are adhered to, some others are not, and this synopsis attempts to outline which principles are implicitly/explicitly adhered to already and which are not.

From the preceding analysis, it can be surmised that Uganda's adherence to the principle of freedom and individualism is mixed. There is some reasonable freedom in everyday life, including the right to engage in economic activities. This has ensured that the country has one of the most enterprising citizens in the world. The country is dotted with many businesses that are started by individuals with minimal restrictions. But there are many other freedoms that are restricted even when they are allowed within the law. This is especially so in cases where those freedoms are politically related; and whereas these seem not to be exactly economic limitations, political policies ultimately will impinge on economic freedoms.

Indeed, the problem with this concept is that it is hard to pinpoint where economic liberty stops and where political liberties, for example, begin. In most cases governments would be content to allow individuals to have their economic liberties but greatly constrain their political and other human rights. It is very difficult sometimes for a person whose other human rights are denied to have economic liberty. Therefore it holds true that for a harmonious society to exist all human liberties need to be respected including economic, political, and cultural ones. This is because these liberties are interrelated and not respecting some means endangering the others. In Uganda this is a problem because there is sometimes selective upholding of liberties with some, such as economic freedoms, mainly being respected but with a number of the liberties of some people not being respected. For example, respect for economic and religious liberties is guaranteed but that cannot be said of political and cultural liberties, with many of these liberties being frequently violated by the state. For example, the right to demonstrate, to protest and to air your grievances is often violated by state organs to the detriment of this important principle of the social market economy. Another cardinal element of this principle would be freedom of the press where individuals are free to listen, watch or read any content of their choice without any undue interference. However, whereas superficially these liberties are enshrined in the Ugandan constitution, they are in many cases violated, and there have been incidents where individuals, especially those with political views that the state finds disagreeable, have been stopped from appearing in some media and some radio or TV programmes have been scrapped because the state finds them displeasing. Similarly, many journalists have been harassed and sometimes imprisoned owing to their views.

In a nutshell, therefore, whereas Uganda has put in place progressive laws, including the constitution, that respects the liberties of the people, the authorities have in many instances violated these liberties and in some cases selectively upheld them. This runs counter to the noble tenets of this important principle of a social market economy that have served the Germany people well.

The principle of order, where the state is supposed to provide a structured economic order, has also partly been adhered to. In Uganda's case, some, but not all, of the regulations that set the order in the economy are available. For example there is a tax law, labour law, some social laws, but there are no strong contract laws. Even those laws that are available are sometimes unevenly enforced, which occasionally creates a sense of chaos and disorder in the society and the economy. And for the institutions that enforce these laws to be able to carry out their functions, they should not only be efficient but also independent. But this is sometimes not the case in Uganda. Many institutions have inadequate facilities and lack the independence to carry out their mandates effectively. For example, the legislature has often been accused of failing Uganda by not carrying out its oversight functions properly. Parliamentarians are frequently accused of putting their selfish needs ahead of those of the nation, with the result that in cases where laws are flouted the culprits are sometimes not censured because they are deemed to be too powerful. Other institutions which are mandated to safeguard order, such as the courts and security forces (like the police), have also often not been independent and efficient enough to carry out this role, leading to impunity which, if not checked, can lead to the breakdown of order.

Other concerns relate to the implementation of economic laws that sometimes seem chaotic and not programmed. Take, for example, the current tax incentives and exemptions that have an ad hoc character, lacking clear guidelines and procedures for awarding them. They tend to be granted on the basis of political rather than economic considerations, thereby benefiting only politically connected investors. Their duration and coverage also tend to be vague, with the tax authorities left in the dark as such decisions are taken by politicians, which complicates tax administration matters regarding such investors. It, therefore, becomes difficult to create economic order when laws are not uniformly and transparently enforced.

Other examples of such disorder can be found in the country's traffic laws and urban development planning. Whereas there is a traffic law that is supposed to regulate movement on the roads, this law is often not enforced. This creates chaos, with all sorts of traffic moving on the roads without any regard for other road users. Consequently, the incidence of accidents on Ugandan roads is one of the highest in the world. Conversely, although there is supposed to be a physical planning law that regulates how developments in urban areas should be undertaken, hardly anyone tries to follow it. The result has been the creation of unplanned settlements with poor drainage and narrow roads and lack of walkways, which has often led to incessant floods and traffic jams.

Another example is that of the environmental protection laws. The National Environment Management Authority (NEMA) is mandated to ensure that natural habitats like wetlands, lakes and forest are not degraded by human activities. In spite of some efforts, however, the environment protection laws have not been followed, with the consequence that most of the protected areas have been invaded by developers, destroying most catchment and drainage areas. This has led to seasonal variations and other climatic changes in addition to floods and other natural catastrophes.

One other reason why the establishment of order has been hard is because of political interference. Many times institutions are unable to enforce laws because of pressure from powerful politicians with a vested interest in non-compliance with the law. Furthermore, in many cases politicians look aside as laws are broken because of political expedience; they fear to lose the support of the lawbreakers. The implication is that the order principle can only be realised if all institutions of the state are working in tandem and when there is political will to enforce the law. Short of that you have patchy enforcement of the law, leading to complacency and impunity, which are a precursor to disorder.

Regarding the justice principle, Uganda has in the recent past made a lot of progress in ensuring justice for its population. A number of laws to ensure a just society have been put in place and institutions of justice have been set up. But the effectiveness of these laws in creating a just society may be subject to scrutiny**.** There have been numerous complaints of favouritism and discrimination by some sections of society. Some regions of the country, especially the north and east, have frequently complained that they are not being given a fair share of the 'national cake'. This has been with respect to resource allocation and equal opportunity in the form of employment, access to social services like health and education, and others.

There have also been complaints to the effect that effort or skill is often not the basis for reward, thereby compromising the principle of just pay. In Uganda there is the principle of what has come to be known as 'know-who', a situation where only politically or otherwise 'connected' people are favoured in place of equally or more qualified counterparts in the competition for opportunities like jobs or contracts. The result has been that innovations and effort have been curtailed, with individuals thinking that the only way to the top is through allying with the powerful even if it means being dishonest.

As for the responsibility principle, its elements are an indication of a stable and mature society. Uganda's hope of becoming a middle-income country will only be achieved if, in addition to its recent impressive economic growth, responsibility by all Ugandans for their country and society is enhanced. Uganda is largely a compassionate country with a well developed traditional welfare system where the whole community takes responsibility for the disadvantaged. Quite often, however, citizens do not care about the protection of the natural resources of the country, and thus take part in environmental degradation that is now threatening the livelihoods of the people.

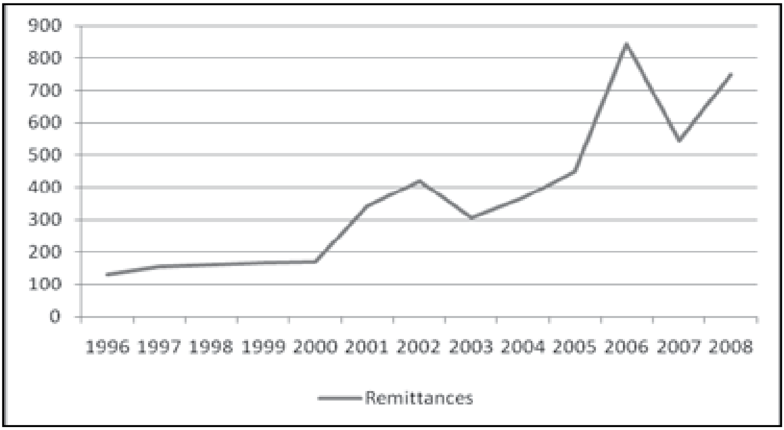
There are also many instances where individuals – or even the society as a whole – act in a way that shows irresponsibility to their communities and to the country as a whole. A case in point is the intolerable noise that some people make at night in residential neighbourhoods, thus denying those communities a chance to have a peaceful night. Others include the discarding of rubbish just anywhere without regard for the beauty of the neighbourhoods. This attitude could be partly informed by the paucity of role models that one would look to for direction as the morals of Uganda's leaders are generally deemed to be questionable. In a society where 'powerful' individuals parcel out land plots in wetlands in disregard for the dangers of floods, lesser mortals will not find it difficult to ignore the need to properly dispose of garbage. The implication, therefore, is that responsible leadership is important if the society is to act responsibly as "low-class" individuals often look to their "upper-class" counterparts for direction and inspiration.

As mentioned earlier, the principle of performance orientation requires that performance is rewarded. However, in Uganda rewarding performance has not always been the norm. There are instances where imperfections in public policy and in the social structure as a whole have favoured individuals that are not always the best qualified or the hardest-working. Examples abound. There are often complaints, for example, that politicians' pay is not commensurate with their performance or contribution to the development of the country. One of the many cases usually cited is that of the discrepancy between the pay of Resident District Commissioners (RDCs), the president's representatives in districts with sometimes ill-defined roles, and that of medical doctors. Given the enormous work that is performed by doctors in Uganda in the country's often overcrowded hospitals, it beats citizens' understanding that they should earn probably only a quarter of what the RDCs earn in salary. This can also be said of many other technical personnel who earn peanuts compared to the army of often underemployed politicians whose contribution to the development of the country is not even clear.

This has often killed the incentive for work, with individuals or society thinking that reward can be achieved through means unrelated to their effort at work. Some have chosen to emigrate to mainly developed countries where they think their performance may be more fairly rewarded, but often ended up doing demeaning work or even being abused. The result has been that many Ugandans in the country and abroad depend on earnings from abroad, and indeed remittances into the country have increased tremendously in the last two decades (Figure 14). This runs counter to the performance orientation principle of the social market economy and efforts should be made to rationalise the incentive structure to ensure that performance is the basis for reward.

As for the principle of competition on the merits, for it to be effective, the regulations that govern fair competition must be enforced consistently and in a fair manner. However in Uganda, this is not usually the case, and mainly because of collusion between big businesses, regulators and law enforcement agencies. Such collusion may involve affording benefits to the business through tax evasion or the flouting of environmental laws, favours that may not be extended to the small competitors. The result is that small and upstart businesses are squeezed out of business unfairly in violation of the principle of competition on the merits. The government has, however, through liberalisation, reduced the incidents of cartels and other monopolies, although more needs to be done in the area of contract enforcement to ensure that competition is indeed on merit.

Figure 13: Remittances received in Uganda 1996-2008 (USD millions)

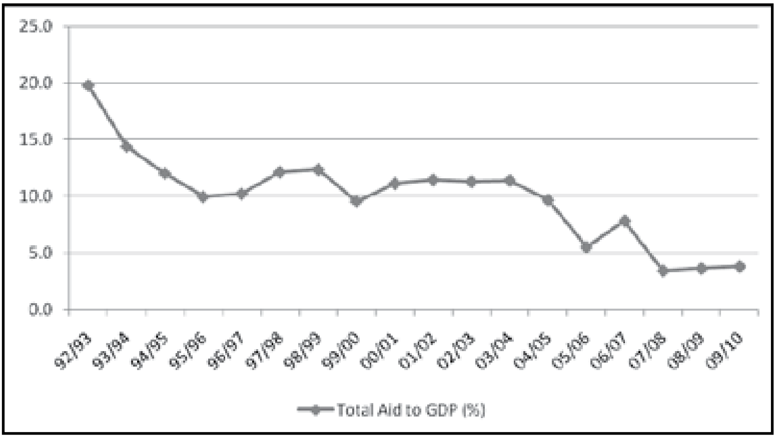


Source: Bank of Uganda

Regarding the principle of solidarity, in Uganda, solidarity at family and community levels has traditionally been strong, with well-off members contributing to the financial and material needs of the community. But the same cannot be said concerning the public level. There are no strong public means of ensuring that members act communally in the interest of others. The liberalisation of the economy since the adoption of the IMF- and World Bank-supported structural adjustment programmes has ensured that in most cases public policy appears unbothered by the vulnerabilities of some sections of the population. Consequently, the solidarity that members usually have at family and community levels is not reflected at national level and in public policy. This has created a nation that often ignores the unfortunate members of the society in favour of the 'each man for himself' mentality, which has created some disillusionment that, if not checked, might breed conflict.

In Uganda, the principle of subsidiarity is to a large extent adhered to as there is a high level of entrepreneurship and self-help by individuals, and within families and communities. However, there is also a high level of dependence because many Ugandans still look to others within their families, communities, or from outside for help. This is partly due to the high fertility rates that have ensured that there is only a small proportion of the population that is engaged in gainful employment. It may also be due to lingering poverty and the structure of the economy that has disadvantaged some sections of the population and left them to the mercy of others. The dependence is also reflected at national level where aid still represents a big percentage of government expenditure. National self-sustenance has not yet been achieved in spite of reasonable progress in the last two decades, as a result of which aid as a percentage of GDP has been declining over time (Figure 12).

Figure 14: Total aid as percentage of GDP



Source: Bank of Uganda, 2009

The principle of common welfare, especially at national level, is problematic. For example, the high prevalence of tax evasion in Uganda is an impediment to this principle. In this case some rich individuals fail to do their part in creating common wealth for the country, thereby denying other less fortunate individuals an opportunity to share in societal wealth. Corruption and greed are also another impediment, and the political class has often swindled resources that were meant for the benefit of all the people.

4.2 Principles of Social Market Economy with Potential to Positively Influence Economic Policies in Uganda

There are different attributes to each of the principles of the social market economy, and whereas some are useful in Uganda some may not be. Put differently, the benefits of the principles of a social market economy are context-specific and may not be universally applicable. It is important that Uganda adheres to those that offer benefits to it. The principles with the potential to benefit Uganda and their potential influence are outlined below.

Most of the principles of a social market economy are actually important for Uganda, but the level of importance varies. And if one was to rank these principles in their order of importance starting with the most important, meaningful ranking could be as follows: Justice - Performance orientation- Subsidiarity- Common welfare – Order – Responsibility - Freedom and individualism - Competition on the merits.

Justice is considered top of the list because Uganda has a long history of injustice. Throughout its turbulent political past, the country has relied on a 'winner-takes-all' philosophy where the vanquished and the weak are denied justice. There has not been a culture of equal opportunity, with the political class that captures power apportioning most of the resources to itself and the rest of the population being relegated to the periphery. This has been the practice whenever one political class has replaced another. For example, an assessment of the distribution of opportunities in all sectors of the economy shows that such distribution favours the region/tribe the top political leaders of the country come from.

For example, whereas before the advent of the NRM government, the executive positions in government and business were dominated by people from the North and East, this has since been reversed and currently these positions are dominated by individuals from the western part of the country, the region from which the president and most of the political class come. This does not stop at government level but permeates all national institutions, including the security forces and other sectors of the economy. There is, therefore, a strong perception in the country that there is injustice in the sharing of the national wealth and that there is no equal opportunity for all.

Therefore, the justice principle of a social market economy is important for Uganda because it would help the country learn how to give all its citizens equal opportunity and reduce the tensions that have always arisen when one section of the population excludes others from partaking of the riches of the nation. This is important because often tensions arising from the feeling of injustice and exclusion create social upheavals that have in the past exploded into conflicts in Uganda.

The principle of **performance orientation** is also considered important because in a way it is linked to that of justice. Individuals have the freedom to work as hard as they can and their performance is the basis for reward and success in the market. But this has often not been the case, as noted earlier, and this has created a cynical society that no longer believes in the value of work. People see others who do little walking away with a big chunk of the nation's resources and they become despondent and demoralised. The principle of performance orientation would, therefore, be important for incentivising work and creating a society that is more tuned to excellence.

The worshipping of the corrupt that is now pervasive in Uganda would end and people would know that honest work pays. This would create a harmonious society where envy and malice would reduce. As noted earlier, this is not to say that the society will stop looking after the disadvantaged, but as they do most would agree that ability is the basis for reward but not 'connections' and power, as was the case in the past and even now.

The **subsidiarity** principle is relevant because Ugandan society has got obsessed with dependence. Even people who can manage to look after themselves still look to relatives, friends, the government or outsiders for help. This has turned the country into one of those with the highest levels of dependence not only at individual level but also at community and national levels. Adherence to the subsidiarity principle would be a major departure from this dependence syndrome and will create a society that is more responsive to its own needs. This is especially important at national level because a country that claims to be independent should be able to provide for itself without looking to the outside world for help. Probably if the country became self-sustaining, its leaders would change their profligate way of life since they would be aware that they would be footing their own bills. This would also create a society that knows how to live within its means and also lead to a way of life that would ensure inter-generational sustainability.

The principle of **common welfare** derives from the three preceding ones in the sense that a society that is just, values work and is self-sustaining will more often than not be able to share its resources equitably. The principle of common welfare is inherent in Ugandan cultures because, from time immemorial, communities have shared whatever they have. This principle is therefore relevant to Uganda, solidarity being a cherished value in the country that ensures that resources are not appropriated by an exclusive club, but that all individuals contribute whatever they can and also equitably share in the resources. This principle is particularly relevant now because some individuals, especially the powerful are reaping where they did not sow - evading taxes while still taking the lion’s share of resources. There is also disregard for the welfare of others, and in some cases government officials have even embezzled funds meant for the purchase of medicine for the wretched of the earth.

The principle of **responsibility** is one that follows naturally from the preceding ones. Responsibility for family and community has traditionally been strong in Ugandan society, where family members look out for siblings, the community cares for the disadvantaged and so on. As noted before, however, the emphasis would need to be put on environmental and natural resource protection to ensure inter-generational sustainability. This is important because Ugandans have abused the natural environment in which they live and the culture of saving for the future is also almost non-existent.

The **order** principle is certainly a prerequisite for any society that claims to be modern and this principle is relevant to Uganda. This, however, does not mean that the type of order that is found in the West, such as in Germany, is necessarily applicable to Uganda. But within the limitations of the Ugandan cultures, the state should provide the structure upon which economic operations should be undertaken. For example, in the Western world the concept of hawkers is not common and the principle of order does not mean Uganda should do away with its hawkers but the rules upon which hawking is done should be put in place. The same applies to other economic activities that may be specific to Uganda or similar countries, such as motorcycle taxis (*boda-boda*). The idea is that any economic activities that Ugandans choose to engage in should be orderly and the rules to guide them should be clear. This is helpful because it sets the rules of the game without interfering with the way the game is played.

Freedom and individualism is also a principle that might be relevant for Uganda. The freedom of purchase, contract, and action, and the freedom to choose employment as well as that to pursue one's own goals are practised in Uganda already. So, in a way, most of the individual freedoms are upheld. As already noted, the freedoms that are still problematic are not economic but rather political, cultural and civil, and whereas they have a bearing on economic choices, those economic choices in Uganda are still considered to be respected. Therefore, in a mainly subsistence economy like Uganda, most individual economic freedoms are respected, except that choices do not mean much in the market.

The remaining principle of the social market economy, namely **competition on the merits**, though relevant for Uganda, might not be all that important because of the nature of the country's economy. The corporate sector is still too small to face any of the competition-related problems those in the developed world face. The regulatory system is also almost non-existent, and businesses usually fail because of their own weaknesses or because of the business environment, but not owing to the anti-competitive behaviour of rivals. Even in the case of those firms that are favoured, this usually happens because of collusion with corrupt government officials rather than as a result of their own business practices.

4.3 The Relevance of the Social Market Economy Concept to Uganda

Since societies differ and considering that what works somewhere may not necessarily work in another situation, it is important to assess whether, as a whole, the social market economy concept is relevant to Uganda. The relevance of the social market economy system derives from what it can bring to the Ugandan economy and its people at this stage of their development. Over the past two decades, the country has seen a remarkable turnaround in economic performance, with the economy growing at a strong and sustained pace of about 7 percent per year over 1997-2007. This has gone hand in hand with a sharp decline in poverty rates that fell by 15 percentage points over this period.

However, this high growth rate and impressive reduction in income poverty levels has come at the cost of worsening distribution of income; a decline in the relative importance of agriculture to overall gross domestic product (GDP); a growing youthful population with increasing unemployment; and a low urbanisation rate. In other words, there has been limited structural transformation, with growth largely emanating from the services sector, which mainly employs the highly skilled and less from the agricultural sector, which still employs 70 percent of the population. What all this means is that the macroeconomic policies that led to this turnaround have run their course and the hands-off approach of the last two decades may no longer be appropriate for this economy. The market failures that have created an army of vulnerable groups, such as the unemployed youth, may need more innovative means to prevent social unrest.

This is where the social market economy system may be relevant. As noted earlier, in a social market economy, the government intervenes in the market to correct the market imperfections, thereby helping those who have been hurt by the market. It also helps to remove the constraints that might be stymieing development, thereby moving the economy to a higher equilibrium level. The Ugandan government has indeed realised that the economy now needs a new impetus and that is what the recently launched National Development Plan (NDP) is meant to provide.

Faced with an economy that is growing but not transforming, the government in June 2010 published its first five-year NDP for the period 2010/2011-2014/2015, the first in a series of six five-year installments that seek to transform Uganda from a peasant society to a modern and prosperous country within a 30-year span. It replaces the PEAP, in place since 1997, as the country's predominant planning instrument that seeks to expand the role of public investment in catapulting the economy to higher growth rates. Priorities for the public investment programme include especially investment in physical infrastructure and expanding the productive capacity of the economy through targeted public investments.

The NDP in a way, therefore, seeks – at least implicitly – to use the concept of social market economy to drive the economy to higher levels of growth and to ensure that those sections of the society left out of the market owing to the 'passive' macroeconomic policy regime can be brought on board. Strong public involvement, which the social market economy approach advocates, is what the economy may now require to not only solve the perennial infrastructural constraints but also to guide it on a path of more meaningful transformation. This, therefore, implies that the concept of social market economy is very relevant now for Uganda's development and the country would be well advised to look carefully at it as a viable alternative to the near-*laissez faire* economic policy that, although it has served the country well in the past, may be inappropriate under the current circumstances.

The government, having experimented with the socialist system in the late 1960s and briefly in the mid-1980s and then the capitalist system for most of the last two decades, might find that the social market economy system, which to some extent it has been toying with for some time, might be the way to go. Not only does it put people at the core of the economic endeavour but it also ensures that government is in tune with what is happening in the economy and is responsible for whatever policies it undertakes. Undertaking economic policies and then ignoring the effects of such policies is an inhuman way of running an economy. That is why the social market economy turns out to be a compassionate system that may be needed at a time when large sections of the population are up in arms about their perceived abandonment by the state.

The concept of social market economy is also consistent with Uganda's democratic aspirations in the sense that a government that wants to be democratic needs to care for the welfare of its citizens. It has to be responsible for the fallout from the economic policies because the voice of the population cannot be ignored in a democratic society. Related to this is the fact that a nation with large sections of the society feeling excluded cannot move on a path of sustainable development, because such groups would have nothing to lose in fomenting chaos, which may create a cycle of violence that is not conducive to economic development.

The implication, therefore, is that sustainable development needs a caring and compassionate government and public policies that are inclusive and all encompassing. This is why social market economy is an attractive concept for a country that not only aspires to create a free environment in which to excel but is also prepared to help its people when they hit the proverbial waves.

5. Summary and Conclusion

Uganda's experience with economic policy since independence has been mixed, but for the last more than two decades, the country succeeded in fostering impressive growth and reducing poverty. But this growth has been criticized by some as non-inclusive, and sections of the population have often complained about being left out from the fruits of this growth. The economy does not seem to have transformed in a way that one would say is deep and fundamental enough as to be sustainable. The result has been that for example, sectors like services that often do not employ a large number of people now dominate the economy, leaving out the majority of the population that still relies on agriculture for their livelihood.

The finger of blame often has been pointed at the liberal policies that the country adopted in the wake of the austerity measures, especially the Structural Adjustment Programmes (SAP) implemented in early 1990s and which have continued in some form for the last two decades. There is a feeling that the adoption of these policies diminished the public role in influencing market outcomes, thereby leaving the people to vagaries of the market. The diminished role of the state and the reliance on external aid has also created a dependence syndrome that cannot be sustainable. A country has a chance of success only if it implements policy that fosters sustainability and whose citizens are the centre of every endeavor of the state. It is not enough to leave the economy to the market and to foreigners because their interest may not rhyme with those of the citizens. It is important that the governments allow the people to take centre stage in running their own country and that the fruits from their resources and economy are not captured by others. This is the only way to insure a stable and sustainable growth path. This has often not been the case and sometimes interests of foreigners and a small powerful group have had the biggest say in the economic path and on how to share the fruits of economic growth.

This has led some to suggest that perhaps developing countries like Uganda should reconsider their policies with the view to initiating changes that will put the population back on the agenda of economic policy. One system that has been cited a possible alternative for countries like

Uganda is the social market economy that countries have adopted with incredible success in economic transformation and inclusive and balanced growth. The best example of the effectiveness of the social market economy is Germany which has used this system to create a resilient economy that not only can withstand downturns as it happened during the recent economic crisis, but has enhanced the welfare of the nation in a profound way.

But an assessment of the Ugandan economy against the principles of the social market economy reveals a mixed picture with the few of the principles that the country's polices conform routinely violated. The result has been that whereas for a social market economy, the focus is individuals, in Uganda powerful interests have been taking the lions' share of the fruits of economic growth. There is a need therefore for the country to re-examine the public role in ensuring that growth is shared equitably between all sections of the population. This will require a compassionate and efficient state that represents the interest of all the people and intervenes in the market to correct the inefficiencies that often hurt the vulnerable. This is the hall mark of the social market economy system and that's what has made it an attractive economic system that developing countries like Uganda struggling with how to create opportunities for its population may be advised to have a look at.

About the Author

Evarist Twimukye holds a PhD in Applied Economics from Clemson University, USA. He has considerable experience in micro-macroeconomic policy analysis especially in the area of growth, social protection, investment, agricultural policy, trade, monetary and fiscal policy. Using Computable General Equilibrium Model (CGE), he has studied the impact aid has had on growth and poverty reduction in Uganda. He has recently been using CGE to analyze how the oil that Uganda has discovered will impact the Uganda economy and especially the agricultural sector. He has also studied the welfare impacts of increasing energy and food prices on especially the very poor in Uganda and how government can protect the vulnerable most affected by these price increases using the expected revenues from the expected oil.

Dr. Twimukye also has previously worked as a Socio-Economist / Monitoring and Evaluation Officer on a DFID-funded project in North-Eastern Uganda, the Client-Oriented Agricultural Research Development (COARD) that extended financial support to the very vulnerable to start agriculture enterprises and as an Economics Lecturer at The Kigali Independent University, Rwanda.

Lately, he has been working with the African Development Bank, the UN and OECD to analyze the outlook for the Uganda economy especially in the wake of the global financial crisis as part of the African Economic Outlook for three year running 2009-2011. He has also been on the team with UN-DESA that has been analyzing the requirements for Uganda reaching the MDGs and he was on the committee that drafted the National Development Plan for Uganda.

In addition to his research and development work, Dr. Twimukye has considerable experience in teaching in Universities in USA and Rwanda. Until recently he was a Senior Research Fellow and the Head of the Department of Macro-economics at the Economic Policy Research Centre (EPRC) where he was undertaking both micro and macro research in the areas of aid effectiveness, Oil and Extractive Industries, Financial Economics, Social Protection, Fiscal Policy, Millennium Development Goals and Public Spending, and micro-macroeconomic modeling. He is also a Technical Advisor to the Uganda government on Planning and other policy issues emanating from the policy work from the centre and has been actively involved in capacity building of government institutions in Uganda.

Dr. Twimukye is currently working as Chief Technical Advisor / Economics Advisor for the United Nations Development Programme (UNDP) in Juba, Southern Sudan.

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Konrad-Adenauer-Stiftung e.V. Uganda
51 A, Prince Charles Drive, Kololo,
P.O. Box 647 Kampala, Uganda
Tel: +256 414 25 96 11
www.kas.de/uganda