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REPUBLIC OF UGANDA

MINISTRY OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

ODI

Budget strengthening Initiative

COUNTRY LEARNING NOTES

Uganda: fiscal discipline and cash management

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SUMMARY

- Explicit political backing for fiscal discipline has been central to the success of Uganda's cash management system, which has proved an effective tool in maintaining fiscal discipline and delivering low and stable inflation for almost two decades.
- Cash management ensures that overall Government spending and Central Bank borrowing during the financial year remain within the limits set in the approved budget.
- It uses rolling monthly and quarterly forecasts of resource availability to establish cash limits on expenditure, and prevents the Government from financing revenue shortfalls during budget implementation by borrowing from the Central Bank.
- However, it only controls overall fiscal discipline, and is not a tool for delivering budget credibility, in terms of ensuring that the budget is implemented as planned at sectoral level.

Fiscal discipline has two main dimensions: setting the approved budget at an overall level that is consistent with macroeconomic stability and resource availability; and executing the budget as planned.

Cash management is an operational tool used to ensure that budget execution is consistent with fiscal discipline at the aggregate level, by limiting expenditures to available resources within the overall ceiling of the approved budget.

HOW AND WHY FISCAL DISCIPLINE EVOLVED IN UGANDA

When Uganda's current government came to power in 1986, after winning a five-year liberation struggle, it inherited an economy devastated by years of mismanagement. Gross domestic product (GDP) per capita had almost halved in real terms since Idi Amin seized power in 1971, and revenue stood at just 7.4% of GDP. At the same time, the expenditure needs associated with rebuilding the country's shattered economic and social infrastructure were enormous.

Faced with significant expenditure pressures, a small revenue base, and low and uncertain volumes of on-budget aid, the Government resorted to financing the budget through domestic

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borrowing from the Central Bank. The Central Bank met Government's financing needs by printing money. The result was highly inflationary. Between 1986/87 and 1991/92, end-period inflation averaged 108%.

Uganda's experience during these years illustrates the dual dimensions of fiscal discipline. Even in years when the Central Bank borrowing requirement set out in the approved budget was reasonably consistent with inflation control, fiscal discipline was undermined by the Government's inability to contain additional expenditure pressures during budget execution, or to reduce expenditures within year in response to revenue shortfalls.

Budget execution in 1991/92 was a case in point. Government experienced a shortfall in both domestic revenue collections and on-budget aid. The aid shortfall was particularly significant, as midway through the financial year, the Government had received only one-fifth of its programmed on-budget aid. Despite these shortfalls, no offsetting reductions were made in expenditures. Instead, these were financed by an increase in government borrowing from the Central Bank equivalent to 40% of the money stock. By April 1992, month-on-month inflation stood at over 10%, equivalent to an annualised rate of over 200%.

Technocrats in the Ministry of Planning had long been making the case to the President that lack of budget discipline was central to high inflation levels in Uganda, and would damage the country's long-term growth prospects. However, responsibility for budget execution lay with the Ministry of Finance, whose officials were more ambivalent about the need for fiscal discipline. The experience of 1991/92 proved to be a turning point, as Planning officials finally convinced the President that the key to inflation control lay in budget control. He merged the two Ministries, and gave the new Ministry of Finance and Economic Planning a clear mandate to enforce fiscal discipline in budget planning and execution.

The results were felt immediately. The new Ministry cut expenditure by the equivalent of 1.8% of GDP in the fourth quarter of 1991/92, to bring spending into line with resource availability. Inflation levels stabilised within three months. From then on, the Ministry of Finance and Economic Planning, with the explicit support of the President, made fiscal discipline the cornerstone of Uganda's approach to budget planning and implementation. Cash management was its central tool for ensuring that expenditures were consistent with resource availability, and that government borrowing from the Central Bank was kept within levels compatible with inflation control. In fact, for the next few years, the Government built up a net saving with the Central Bank, while inflation was consistently below 10% per annum.

TABLE 1: KEY INDICATORS BEFORE AND AFTER IMPOSITION OF FISCAL DISCIPLINE (AVERAGE)

	1986/87–1991/92	1992/93–1996/97
Domestic government financing (% GDP)	1.2%	-1.4%
Change in Central Bank Net Credit to Government (% money stock)	16.5%	-15.0%
Annual growth in average level of money (M2)	105.5%	28.6%
Average end-period inflation	107.6%	6.6%

IMPLEMENTATION OF CASH MANAGEMENT WITHIN THE OVERALL BUDGET PROCESS

At the start of the budget preparation process, the Ministry of Finance estimates the overall level of resources available to finance the budget, consistent with its targets for macroeconomic stability and fiscal discipline. Known as the 'Resource Envelope', these estimates have three major components: revenue, expenditure and financing. The aim is to ensure that any projected difference between revenue and expenditure

TABLE 2: COMPONENTS OF THE RESOURCE ENVELOPE

	MAJOR COMPONENT	SUB-COMPONENTS
A	Revenue and grants	Domestic revenue (tax and non-tax) Donor grants
B	Expenditure	Wage, non-wage recurrent and development
C (= A-B)	Overall fiscal balance	
D (= -C)	Net financing	External debt (new loans net of repayments) Domestic debt (bank and non-bank)

can be financed without resorting to levels of domestic borrowing from the Central Bank (known as 'Net Credit to Government') that are incompatible with low and stable inflation.

Once the budget has been submitted to Parliament, the Ministry of Finance's Macro Department starts the process of estimating the Government's monthly cashflow for the financial year. It bases its estimates on the components of the Resource Envelope set out above, taking into account any expected month-to-month variations in inflows such as domestic revenue and donor grants. At the same time, it compares estimated cash availability with expenditure needs, as projected by the Budget Directorate, on the basis of information provided by spending agencies. The aim is to set cash limits on expenditure that are consistent with resource availability, so that Net Credit to Government remains within the level established in the budget.

When Uganda first started using cash management in 1992 as a tool to instil aggregate fiscal discipline, cash limits were set on a monthly basis. Given the Government's precarious financial situation, they tended to be tied to the level of the previous month's resource inflows, net of external debt repayments. Spending was limited to cash at hand, as it were. Decisions on how the cash projected by the Macro Department should be divided between major categories of spending were made by a multi-departmental Releases committee within the Ministry of Finance. This committee aimed to allocate resources in a way that minimised the disruption caused by any within-year cuts (in the event that revenues were lower than forecast), and to protect 'pro-poor' expenditures.

Over time, as Government has consolidated its financial position, and achieved a greater level of stability and predictability in its resource inflows, there have been four main developments in Uganda's approach to cashflow management.

- First, the Budget Directorate was made responsible for allocating resources to spending agencies within the cash limits communicated to it by the Macro Department. The cash limits identify the amounts to be allocated to major expenditure categories such as wages, and non-wage recurrent and development expenditures, as well as to cover statutory obligations such as interest payments and ring-fenced 'pro-poor' expenditures. From there, the Budget Directorate divides the available resources across spending agencies, taking into account known commitments and recurrent needs.
- Second, a system of commitment control was introduced in 1999/2000, which involved the setting of commitment limits as well as cash limits. This aimed to limit financial commitments as well as actual expenditures expenditure to the cash available during the financial year, and thereby reduce the accumulation of arrears. This was necessary, because the system of cash management was unable to prevent spending agencies from incurring payment commitments outside of their cash limits.
- Third, limits were no longer restricted to the resource inflows of the previous quarter. Instead, the Government is able to build up and run down its position with the Central

Bank on an inter-quarter basis, within the overall limit set for Net Credit to Government for the financial year, to achieve a degree of 'smoothing' in its expenditure profile. In addition, any shortfall in on-budget aid inflows relative to programme estimates can be compensated for by an increase in Net Credit to Government for the financial year as a whole, while any surplus is saved. However, in the event that Government experiences a shortfall in domestic revenues over the course of the financial year, expenditures must be cut by the equivalent amount.

- Fourth, since 2010 , cash limits have been set on a quarterly rather than monthly basis, using aggregated monthly estimates. Cashflow estimates and cash limits for the current quarter take into account outturns for preceding quarters. Expenditure limits are then communicated to spending agencies. The agencies submit for approval their expenditure plans for the quarter consistent with the limits to the Budget Directorate, prior to releases taking place.

ISSUES IN CURRENT PRACTICE

Uganda's cashflow management system has been extremely successful in delivering fiscal discipline at the aggregate level. The evidence for this is the country's consistent track record in achieving low and stable inflation for almost two decades, despite occasional food price shocks. However, it has been less successful in ensuring that the budget is implemented as planned, in terms of allocations to spending agencies. Certain elements of the budget have been protected, such as salaries, statutory, local government transfers and other pro-poor expenditures. Nevertheless, non-wage recurrent and development budgets are often subject to cuts.

Uganda's Budget Act (2001) places a 3% limit on any changes to the budget (known as 'supplementary expenditures') after it has been approved. However, unbudgeted expenditure demands have been growing in recent years, weakening budget credibility even as overall fiscal discipline has been maintained through the consistent use of cash management.

Furthermore, the system of commitment control has been only partially successful, as suppliers have proved willing to deliver goods and services to spending agencies outside of the system, in the knowledge that they will eventually be paid. Once again, the continuous accumulation of domestic arrears undermines budget credibility.

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