BANK OF UGANDA

STATEMENT BY MR. EMMANUEL TUMUSIIME MUTEBILE, GOVERNOR BANK OF UGANDA, ON THE MOBILIZATION OF DOMESTIC RESOURCES FOR DEVELOPMENT

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Mr. Chairman,

Allow me first to congratulate the Ministries of Finance, Planning and Economic Development and Foreign Affairs for organizing this national stakeholders preparatory workshop on Financing for Development (FfD). As you are all aware, the UN is organizing a global conference on confronting challenges of financing development in Mexico between 18 – 22, March 2002 and preparatory meetings have been held in New York and at national levels in many countries. It is therefore timely that a national stakeholders workshop to develop the Uganda position for this conference is now taking place.

Mr. Chairman, today's consultative workshop will feature presentations and discussions on five thematic areas, and I am privileged to present one on the theme of *Mobilizing Domestic Resources for development*. But I intend to touch in passing on other issues in the international economic order which impinge on this topic.

Mr. Chairman, In my statement to the 3rd Session of the preparatory conference for U.N. Conference on Financing for Development (FfD) which was held at the United Nations in New York in May 2001, I said that the Uganda delegation firmly believed that the solution to the development problem was not just an increased quantum of resources, both domestic and external, useful though that increase is. Rather, we believe that this is just part of the solution. The more important part of the solution involves the more efficient use of whatever resources are available, particularly the efficient use of the available resources by the developing countries themselves, coupled with reforms in the global trading system to create a level playing field for the developing countries as well as reforms not just in the international financial architecture but in the global development countries, as well as in the multi-lateral trading, financial, and developmental architecture. For the FfD process to succeed, Mr. Chairman, business as usual will not do. The Uganda Delegation was therefore, disappointed that these issues are not yet squarely on the agenda. Certainly not in an adequate manner. More money is certainly a necessary condition for increasing the tempo of development, but it is far from being a sufficient condition for progress in the FfD process.

We would, therefore, like to see more emphasis being placed on the importance of a good macro-economic environment in the developing countries as the bedrock on which we can all build the efforts of mobilization of additional resources for development from domestic economies of the developing countries as well as from the developed countries and from the multi-lateral financial and technical assistance institutions. Moreover, external savings should supplement and not supplant the domestic revenue efforts.

I am glad to see that in the latest draft the facilitator of the preparatory conference has included more paragraphs on the importance of macroeconomic stability, the need for fiscal sustainability and the need for increasing the efficiency of resource use.

I said in New York that the Ugandan Delegation would like to emphasize that however successful the FfD process is in raising the level of resource transfers to poor countries, not only will this increased level of resources still be insufficient ,relative to the financing needs of the developing countries, but more importantly, resources will by definition continue to be scarce relative to needs everywhere, even in the developed countries. This is not saying anything new as this is what economics is about, but given the apparent misunderstanding of this point, especially by Stakeholders outside governments and multi-lateral agencies, it is important for the DfD conference to flag this need for economy and efficiency in resource allocation and resource use, both in the public and the private sectors.

As we make progress in the very welcome endeavour to involve an ever-widening circle of Stakeholders in our discussions, and as we develop a comprehensive, integrated and holistic agenda for the FfD process, we can ill afford allowing the impression to grow that comprehensiveness and all-inclusiveness means that the FfD process will somehow release the developing countries from the need to make the hard choices which are necessary in order to prioritise proposals for developing financing within an overall resource constraint that is consistent with the best estimate of the level of resources most likely realistically to be available in any budget year or in the context of a medium Term Public Expenditure Framework, at least for those development interventions which require financing from public resources.

It is necessary to underscore this point because some of the stakeholders in the FfD process have argued in some other international fora that the Comprehensive Development Framework proposal by the World Bank is a welcome development which will liberate the Line Ministries of developing country governments from the shackles of the bean counters at Ministries of Finance. Such Stakeholders will not fail to see in the prospects for a successful FfD an even better opportunity for throwing away the shackles of fiscal discipline. Such an interpretation would be a catastrophy. The hard budget constraint is a fact of life in the developed countries as well as in the developing countries and this message needs to come out loud and clear. It is true that if we could succeed in persuading many more developed countries to move towards the UN target of aid transfers equivalent to 0.7% of GNP, the financing constraints for developing countries might be relaxed somewhat. Nevertheless, the budget constraints would not be removed thereby.

That is why economic and financial reforms are imperative; reforms in the developing countries' economies as well as reforms in developed countries in order to enable the most efficient global allocation of resources to take place, by both the public sector as well as the private sector.

We have always heard about the reforms which must be implemented in the domestic and external sectors of the economies of the developing countries in order to improve resource mobilization and to increase the efficiency with which those resources are used. I do not propose to go into them here, particularly since there has in recent years developed a congruence and convergence of views on what these reforms are and how they should be implemented. What is not generally heard about, and certainly not so loudly, are the equally important reforms that are needed in the developed countries in order to ensure that their domestic economic policies are wholly consistent with their capacity to help developing countries to help themselves by exporting to developed country markets.

This refers not just to market access but also to the issue of subsidies for domestic producers in the developed countries, and particularly to the subsidies for domestic agricultural production and domestic agricultural exports of the developed countries. However much Uganda opens up its economy to the forces of globalization, Uganda's poor agricultural farmers will have no chance in hell in raising themselves out of poverty when there is no level playing field in agricultural production and agricultural trade globally.

The process of mobilizing domestic resources faces many challenges but I will name only two; the challenge of generating an increasing stream of domestic resources and the challenge of efficiently channeling them to productive investment. To overcome these challenges requires an enabling environment in the form of sound macro-economic policies to underpin financial stability and to promote private savings and investment. These policies must include a full-scale liberalization of the financial sector, including allowing the capital and money markets to determine the prices of financial assets and other money market instruments. The fiscal authorities must also consolidate public finances and provide an effective mechanism for allocation of public expenditures while crowding in the private sector. Securing fiscal sustainability through medium term expenditure frameworks is vital for promoting the mobilization of domestic resources. Other supporting measures such as the rule of law, a sound legal system, security of person and property, transparency of governments and the popular participation in the process of governance become very important.

In light of the above, Mr. Chairman, I would want to propose that the FfD Conference in Mexico underlines the need for national macroeconomic polices to aim at building medium term frameworks that balance the objectives of sustained economic growth and poverty reduction. In addition, national economic policies should ensure that inflation is sustained at low levels and that fiscal and current account balances are sustainable.

To achieve the above objectives, there is need to strengthen the domestic financial sector to improve public finances and to address other systemic issues that affect the mobilization of domestic resources.

Strengthening the Domestic Financial Sector –

The central role of the financial sector is to intermediate financial resources at the lowest transactions costs possible in order to facilitate an efficient allocation of resources for financing productive enterprises and offering savings and credit facilities. A fundamental prerequisite of successful domestic resource mobilization is the restoration of macroeconomic stability. Only financial stability can induce private individuals to hold in the form of financial savings whatever surplus incomes they possess rather than holding the surplus income in the form of tangible assets or in the form of informal sector savings. Financial stability also lengthens the planning horizons of economic agents and facilitates the judicious risk taking that is required for increasing investment.

Financial deepening which means the accumulation of financial assets at a rate higher than the rate at which non financial wealth is being accumulated, is also extremely important for the mobilization of domestic savings.

The FfD process should therefore ensure that all countries support the good functioning of financial markets through establishing a transparent and efficient legal framework supported by effective and supervisory institutions so as to reduce excessive risk taking and moral hazard. The need to foster good corporate governance, accounting and audit practices in private and public entities, in addition to facilitating efficiency and innovation in financial services should be emphasized in the FfD process. Mr. Chairman, I am glad to report to you that the Financial Institutions Bill which, is about to be presented to Parliament addresses a number of these issues and will particularly focus on improving governance in the banking industry.

We must unceasingly endeavor to strengthen and diversity our financial sector so as to respond to the multi-facets needs for financial services. This should particularly be seen in areas of promoting household savings and facilitating long-term investment. Consequently, markets for public and private bonds and equities should be developed, institutions such as pension funds, life insurance companies, mutual funds, development banks and non-bank financial institutions should compete in open markets in order to ensure that domestic resources are efficiently used.

Facilitating access to finance by small and medium sized enterprises by provision of micro-credit, as well as through the introduction of segments of stock markets adopted to the needs of small and medium-sized enterprises ought to be at the center of our policies. However, on the part of the enterprises themselves, transparency, innovative market based financing appropriate to small enterprises such as venture capital, collective investment schemes, leasing and issuance products should be encouraged.

Mr. Chairman, given that the level of poverty in our country is in itself a constraint to resource mobilization, it is important that government moves swiftly to implement projects and programmes aimed at reducing poverty. One such mechanism is through the development of micro-credit schemes that would provide small rural producers with equitable access to credit, crop (weather) insurance and other financial services. The development of a legal framework and other supporting measures that facilitate micro-credit institutions could play an important role in this regard. I am again glad to report to you that the Micro Finance Institutions Bill about to be presented to Parliament addresses these issues.

All countries through the FfD process, should endeavor to increase access to financial services for the poor and vulnerable groups by fostering a wide range of financial intermediaries that largely serve small savers and borrowers, micro enterprises including micro-finance, postal savings and co-operatives. To this end, governments and donors should provide resources to the poor and vulnerable through some market based mechanism. International public-private partnership to encourage research and development of innovative financial tools are also needed.

We must also take whatever measures are necessary to reduce the vulnerability of the international and domestic financial systems to crisis and contagion. Self-assessments or externally funded ones such as the IMF Financial Sector Assessment programs (FSAP's) and reports on observance of standards and codes (ROSCs) should be taken seriously. In this respect the FfD process through bilateral and multi-lateral financing should be urged to build capacity by way of appropriate technical assistance in areas related to strengthening of the financial sector.

National authorities should also explore the development of pension funds industry taking into account its sustainability, its potential impact on savings mobilization and its impact on the development of the financial sector. As experiences in pension reforms vary across countries, technical assistance from the international community could support the sharing of such experiences between countries.

Mr. Chairman, sound fiscal systems and the provident management of public expenditures are important supports to the domestic resource mobilization efforts. By definition, the financing requirements of Governments are always greater than the resources available to fund these expenditures. Therefore, proposal for Government expenditure must per force be constrained by the resources available or realistically most likely to be available. This means that the hard choices involved in prioritization of things we want to do cannot be avoided, however much money could be raised in the FfD process.

To this extent therefore, we should request the high level event in Mexico to strongly urge countries to formulate Medium-Term Expenditure Framework in order to provide a measure of predictability of public spending and to set out clear goals for the mobilization of both tax and non-tax revenues.

Mr. Chairman, in addition, national, regional and local authorities should establish budget procedures and facilitate the participation of civil society in the review of public expenditures with a view of enhancing efficient and equitable provision of health, education, social security, infrastructure services and safety nets. This would go a long way in promoting transparent procedures and reviews besides helping governments to protect expenditures on priority program areas, enhancing cost-effectiveness of public programs, correct those that are mis-targeted and to evaluate their impact on the poor and the vulnerable.

Increasing Public Revenues

Mr. Chairman, in addition to rationalizing Government expenditures, there is need for a well balanced, broadly based, equitable and economically neutral tax system. The tax system should be economically neutral in the sense that it minimises features of the tax system which tend to distort the judgements of economic agents in their choice of techniques of production and in their allocation of resources to their most efficient use.

Mr. Chairman, allow me to propose some measures here that could enhance revenues of developing countries in the medium term.

- Countries must avoid the "race to the bottom" involving competition with each other in offering increasingly better tax incentives for foreign investors. A more effective incentive is to increase the level of allowances given at the time of investment, if not altogether writing off the capital investment costs against taxes.

- Development of a progressive system of taxation by making sure that the incidence of taxation falls justly on different income classes.

- Countries must widen the base of their consumption tax systems to include more indirect taxes that target the growing modern service sector and to penalize socially and environmentally undesirable activities.

- Countries must strengthen their institutional, technical and technological capacities in taxation through simplification of tax laws in order to improve efficiency and effectiveness of tax administration and enforcement.

- Countries must intensify measures to increase tax enforcement, to combat tax evasion and to minimize tax exemptions.

- The tax base should also be widened by the integration of the informal sector into the main stream of the economy. *Presumptive* taxation of well-defined categories of informal enterprises on the basis of some proxy for income should be implemented. Such efforts, however, risk increasing tax avoidance and should be accompanied by measures to increase public service delivery.

Addressing Systemic Issues

Mr. Chairman, in a highly globalized world, sound macro-economic policies at any national level, can lead to increased inflow of capital which could also increase the national productive capacities. However, there are also dangers associated with such inflows as we recently saw in the case of the South-East

Asian economies. In the absence of a strong, well-regulated banking system, fiscal prudence and proper sequencing of macro-economic reforms, capital account liberalization could disorganize both the savings and investment patterns of the recipient countries. However, I wish to caution here that capital controls should not be used as a substitute for sound macro economic policies, rather the existing polices should work towards strengthening the credibility of Government policy over time to increase private sector confidence which is the foundation for capital account liberalization. In addition, the FfD process could consider financing through bilateral and multilateral donors to provide technical assistance to developing countries that are faced with increasing capital inflows. The technical assistance should not only monitor capital inflows but also finance studies by Consultants to generate data that can enhance effective policy making in developing countries. This would enable the recipient developing countries respond efficiently to the consequences of the ebb and flow of capital across the borders of fragile economies.

Macroeconomic policies of OECD countries to a large extent influence the international economic and financial environment. These countries bear some responsibility of supporting global economic growth and in dampening abrupt changes in interest rates and international capital markets. The developing countries should also endeavor to create new instruments and markets to manage the risks associated with interest and exchange rate fluctuation in order not to disrupt the domestic resource mobilization efforts associated with such fluctuations.

It would therefore, be useful if the high level event in Mexico agrees that the international community creates and promotes an international economic environment supportive of sound macro economic policy and domestic resource mobilization in developing countries. In addition, the OECD countries should also pursue polices that are supportive of global economic growth, consistent with a stable international economic environment.

Finally Mr. Chairman, just like the global fight against terrorism has received international support, the developing countries should urge the Mexico Conference to marshal international support in the fight against capital flight caused by fraud and embezzlement of public resources by thieving public servants from the developing countries. Such resources are normally banked safely in developed financial markets while the developing countries are denied these scarce resources to finance the existing investment gaps in their economies. Improved governance, accountability and strengthening of the financial sectors on the part of developing countries should however parallel these efforts.

I look forward to active participation in today's event.

Thank you for your attention.